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Crafting markets in Taiwan: technocrat leadership, ruling party politics and financial reform in the late 1980s

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-Statement of authenticity-

I declare that this thesis is the result
of my own original work
and all sources have been acknowledged.

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-Abstract-

Financial liberalization in Taiwan during the late 1980s was juxtaposed against a history of strong government intervention in all areas of finance. From banking, to the stock market, to the foreign exchange system, the ruling Kuomintang (KMT – *Guomindang*) controlled or meddled in almost every facet of credit allocation. And then everything changed. By the early to middle 1990s, Taiwan was fast losing its reputation as a protected market for savings and investment, and steadily acquiring a capacity to compete with the financial service industries of Hong Kong, Tokyo and Singapore. Just how did the Taiwan financial system move from virtual autarky to an increasingly open market for credit in around half a decade? Why did the KMT regime, hardly a traditional domicile of liberal economic thought, choose to loosen its grip on the commanding heights of the economy?

The argument of this study is that the *leadership practices of technocrats matter* in financial policy change. Ultimately, it was the ideas and opportunities of Taiwan's economic technocracy that left the most fingerprints on new policy initiatives introduced during the watershed years of the late 1980s. To test this proposition, I propose a model of KMT 'policy windows' based on recent work by Jeff Checkel. The term policy window refers to a change in party politics that provides entrepreneurial technocrats with an opportunity to pursue their ideas for policy reform. Research results include: (1) evidence of independent programs for financial reform advanced by the economic technocrats, as well as instrumental links between the emergence of KMT policy windows and technocrat reform efforts, and (2) evidence of a broad temporal correlation between Taiwan's three main episodes of financial liberalization and the opening of various KMT policy windows.

The thesis speaks to a narrow theoretical debate within political economy regarding the international trend toward financial opening in the last two to three decades – an academic discourse that has recently been subsumed within broader discussion on economic globalization. Traditionally, this debate is divided among four schools: statist analysis, pluralism, the foreign pressures model and the market-driven approach. The thesis makes use of several types of research material and techniques. These include: biographical sources, historical literature, popular media publications, interview data and counterfactual thought experiments. Where possible and appropriate, the study seeks to engage with Chinese language academic works. While the thesis is primarily intended as a generalizable work of social science, it also has important implications for those specifically interested in Taiwan's contemporary economic history.

-Acknowledgements-

I have always considered it strange that any large academic work can have a single author when the input of so many institutions and individuals is required to produce it. This is probably truer of my thesis than most. As for institutions, I am of course most beholden to the Department of International Relations at ANU. The IR Department provided all the academic, financial, logistical and personal support that a PhD student could possibly expect of a scholarly institution, and I suspect my project would have floundered very early in lieu of this. In Taiwan, I received generous support with fieldwork research and language training from the National Institute of Policy Research, the Politics Department at National Chengchi University and the RoC Ministry of Education. These institutions helped with interviews, data collection, visa hurdles and, during my final year in Taiwan, a generous scholarship. My time in Taipei would have been much shorter and less productive without this help.

The list of individuals who I must thank for their professional input into the thesis includes (or included) some of the sharpest minds in Australia and Taiwan. At ANU, I received research guidance from John Ravenhill and, some time later, Greg Noble. Both are outstanding scholars and extraordinarily difficult to please. Anything that is good about this thesis is attributable to their persistence. In Taiwan, I received further help from Chu Yun-han and Kuo Cheng-tian. Both were generous with their time and contacts, and enabled me to cut through a lot of red tape while doing fieldwork interviews. I should only hope visiting PhD students from Taiwan receive as warm a welcome in Australia. My debts of gratitude to other contacts in Taiwan are too numerous to recount here, although I must make special mention of Jeff Cox from the ANZ Bank in Taiwan, and Jack Huang from the *China Post* newspaper. They gave much needed employment to a struggling student, and provided me with a unique opportunity to study the world of Taiwan business and finance from the inside. To the remaining government officials, businesspeople, politicians, journalists, academics and fellow *tongxuemen* who gave of their time in interviews or other ways, I am profoundly grateful.

Beyond the professional, there are friends and colleagues who have given much more than they will ever know. At ANU, I must make mention of Greg Fry, Zhu Tian-biao, Zhang Yong-jin, Malcolm Cook, Amy Chen, Lynne Payne, Anthony Langlois, Jamie Greenbaum, Sandra Eccles, Pru Gordon, Stuart Harris, Liz Gardiner, Hazel Lang, Gavin Mount, Andy Mack, Yuki Tanaka, Robin Ward, Chris Reus-Smit, Heather Rae and the night watchmen of the Coombs building. Special thanks go to Wynne Russell for reading through the final draft of the thesis, and for countless conversations on the human condition. Outside the hallowed halls, I must thank Kally King, Zhou Mei-nu, Gao Zhong-xie, Liu Min-ying, Liu Mei-zhen, Ye Dage and Dasao, Michelle McGinity, Mike Silberman, Richard Matijic, Simon Vanderaa, Subho Banerjee and Michael Arpula. Some of these people I have lost contact with commuting between Taipei and Canberra over the last few years – for this I am profoundly sorry. Finally, thanks to my family and the light of my life, Sonia Wu. Writing a doctorate brings out the best and worst in people; I can only hope that those closest to me choose to remember the former and forgive the latter.

I dedicate this thesis to the memory of John Singleton, a workmate and friend who died under tragic circumstances in 1987. There but for God's grace go I.

Craig Meer
Australian National University
December 2001.

-Contents-

-Tables and diagrams-

-Abbreviations-

CBC	Central Bank of China
CCIS	China Credit Information Service
CCK	Chiang Ching-kuo
CEPD	Council for Economic Planning and Development
CNC	Chinese National Currency
CPA	certified practicing accountant
CPI	consumer price index
DPP	Democratic Progressive Party
EOI	export oriented industrialization
EY	Executive Yuan
GDP Def	GDP deflator, broad measure of inflation
GNP/GDP	gross national/domestic product
KMT	Kuomintang
LY	Legislative Yuan
M1A	monetary measure, currency plus deposits at banks
M1B	monetary measure, M1A plus long term deposits
M2	monetary measure, MIB plus quasi-money
MoEA	Ministry of Economic Affairs
MoF	Ministry of Finance
NBL	National Bank Law
NT$	New Taiwan Dollar
OBU	offshore banking unit
R&D	research and development
RoA	return on assets
RoC	Republic of China
RoE	return on expenses
SAFE	Statute for the Administration of Foreign Exchange
SEC	Securities Exchange Commission
SEL	Securities Exchange Law
SITEs	securities investment trust enterprises
SME	small to medium sized enterprises
Taiex	Taiwan Stock Exchange index
TICs	trust investment companies
TSE	Taiwan Stock Exchange
WPI	wholesale price index
XO	fortified alcohol/hypothetical country

-Chinese terms and names-

100 years of shame	*bainian chiru*	百年耻辱
10th Credit Cooperative scandal	*Shixin fengbao*	十信風暴
annual common exam (for govt. service)	*pukao*	普考
annual high-level exam (for govt. service)	*gaokao*	高考
Asia-Pacific Regional Operations Center	*Yatai Yingyun Zhongxin*	亞太營運中心
bank legislators	*yinhang liwei*	銀行立委
black-gold (politics)	*heijin*	黑金
branch (of government)	*yuan*	院
cast-iron votes	*tiepiao*	鐵票
Cathay Group	*Guotai Jituan*	國泰集團
Central Bank of China	*Zhongguo Zhongyang Yinhang*	中國中央銀行
Central Government	*Zhongyang Zhengfu*	中央政府
Central Standing Committee (of the KMT)	*Zhongchenghui*	中常會
Chairman (of the KMT)	*Zhuxi*	主席
Chang Chi-cheng	*Zhang Ji-zheng*	張繼正
Chiang Ching-guo	*Jiang Jing-guo*	蔣經國
Chiang Kai-shek	*Jiang Jie-shi*	蔣介石
Chien, Robert	*Qian Chun*	錢純
China Credit Information Service	*Zhonghua Zhengxinsuo*	中華徵信所
China Steel	*Zhong Gang*	中鋼
Chinese National Currency	*Fabi*	法幣
common home town	*tongxiang*	同鄉
comrade in arms	*zhanyou*	戰友
County Government	*Xian Zhengfu*	縣政府
credit cooperative	*xinyong hezuoshe*	信用合作社
Democratic Progressive Party	*Minjindang*	民進黨
economic miracle	*jingji qiji*	經濟奇蹟
Economic Reform Committee	*Jinggaihui*	經改會
enterprise group	*qiye jituan*	企業集團

Executive Yuan	*Xingzheng Yuan*	行政院
finance technocrats	*caijing guanliao*	財經官僚
financial liberalization	*jinrong ziyouhua*	金融自由化
financial opening	*jinrong kaifang*	金融開放
five man finance and economics small group	*wuren caijing xiaozu*	五人財經小組
Formosa (opposition magazine)	*Meilidao*	美麗島
Fourteen Major Projects	*Shisixiang Jianshe*	十四項建設
Fuh Hwa Securities Finance Company	*Fuhua Zhengquan Jinrong Gufen Youxian Gongsi*	復華證券金融股份有限公司
general mobilization goods	*guojia zongdongyuan wuzi*	國家總動員物資
hot money (direct trans. from English)	*riqian*	熱錢
hot money (formal, lit. 'water capital')	*youzi*	游資
Hsu Li-teh	*Xu Li-de*	徐立德
Industrial Development Bureau (of the Ministry of Economic Affairs)	*Gongyeju*	工業局
industry associations	*gongye xiehui*	工業協會
Institute of Securities Market Development	*Zhengquan Shichang Fazhan Jijinhui*	證券市場發展基金會
Intellectual (opposition magazine)	*Xuezhe*	學者
KT Faction	*KT Pai*	KT 派
Kuo, Shirley W.Y.	*Guo Wan-rong*	郭婉容
Kuomintang	*Guomindang*	國民黨
Kuomintang/party cell	*Guomindang xiaozu*	國民黨小組
Kuomintang/party headquarters	*Guomindang zhongyangdangbu*	國民黨中央黨部
Lee Teng-hui	*Li Deng-hui*	李登輝
Li Kwoh-ting	*Li Guo-ding*	李國鼎
liberalization, internationalization, systemization	*ziyouhua, guojihua, zhiduhua*	自由化, 國際化, 制度化
local factions	*difang paixi*	地方派系
Mainlander (ethnic identity)	*waishengren*	外省人
martial law	*jieyan*	戒嚴

Minister of State or Minister Without Portfolio	*Xingzhengyuan Zhengwu Weiyuan*	行政院政務委員
Ministry of Finance	*Caizhengbu*	財政部
National Bank Law	*Yinhangfa*	銀行法
national coffers are linked to the party	*guokuo tong dangku*	國庫通黨庫
National Taiwan University (NTU) gang	*Taida bang*	台大幫
new banks	*xin yinhang*	新銀行
New Taiwan Dollar	*Xin Taibi*	新台幣
opposition (lit. 'outside the party')	*dangwai*	黨外
party leads the forces	*yidang lingjun*	以黨領軍
political-business networks	*zhengshang wanglu*	政商網路
political-business relationships	*zhengshang guanxi*	政商關係
promulgation	*gongbu*	公布
push forward foreign exchange reform	*tuidong waihui ziyouhua*	推動外匯自由化
related enterprise	*guanxi qiye*	關係企業
Republic of China	*Zhonghua Minguo*	中華民國
retake the mainland	*fangong dalu*	反攻大陸
returnee (students and professionals)	*haiwai xueren*	海外學人
Second Stage Agricultural Land Reform	*Dierge Nongye Ludi Gaige*	第二個農業陸地改革
Securities Exchange Commission	*Zhengquan Guanli Weiyuanhui*	證券管理委員會
Securities Exchange Law	*Zhengquan Jiaoyi Fa*	證券交易法
securities investment trust enterprises	*zhengquan touzi xintuo gongsi*	證券投資信託公司
senior/elderly party officials	*zhengdang dalao*	政黨大老
Sino-US Exchange Talks	*Zhong-Mei Huilu Tanpan*	中美匯率談判
Small to Medium sized Enterprise Bureau (of the Ministry of Economic Affairs)	*Jingjibu Zhongxiao Qiye Ju*	經濟部中小企業局
small to medium sized enterprises	*zhongxiao qiye*	中小企業
Special Municipal Administration	*Zhixia Shizhengfu*	直轄市政府

speculator	*toujizhe*	投機者
Statute for the Administration of Foreign Exchange	*Guanli Waihui Tiaoli*	管理外匯條例
Taipei Beancurd Traders Association	*Taibeishi Doufu Shangye Tongye Gonghui*	台北市豆腐商業同業公會
Taiwan Provincial Government	*Taiwan Sheng Zhengfu*	台灣省政府
Taiwan Stock Exchange	*Taiwan Zhengquan Jiaoyisuo*	台灣證券交易所
Taiwanese (ethnic identity)	*benshengren*	本省人
technocrat (economic administrator)	*jingji guanliao*	經濟官僚
technocrat (lit. 'technology bureaucrat')	*jishu guanliao*	技術官僚
Temporary Provisions During the Period of National Crisis under the Communist Rebellion	*Dongyuan Kanluan Shiqi*	動員勘亂時期
Ten Major Projects	*Shida Jianshi*	十大建設
Three Principles of the People	*Sanmin Zhuyi*	三民主義
trust investment companies	*xintuo touzi gongsi*	信託投資公司
Tsinghua University	*Qinghua Daxue*	清華大學
underground investment company	*dixia touzi gongsi*	地下投資公司
underground/curb market	*dixia shichang*	地下市場
Wang Chien-shien	*Wang Jian-xuan*	王建煊
Yu Faction/Family	*Yu Xi*	俞系
Yu Kuo-hwa	*Yu Guo-hua*	俞國華

-A note on Chinese terms and Romanization-

This thesis adopts the standard Chinese practice of placing family names first (e.g. Hsu Li-teh) except for Westerners, all citations (when cited as an author in footnotes, Hsu becomes Li-teh Hsu) and where Chinese people have adopted Western names (e.g. Robert Chien). Chinese names are reproduced in the Romanized form commonly used by the person or place concerned (e.g. Lee Teng-hui or Taipei). Where names have change over time (in more recent years, Li Kwoh-ting spelled his name as Li Kuo-ting) I use the original version, except in those citations that use the new form. For important terms or people, I provide the Chinese expressions in *Hanyu Pinyu* in parentheses (but only once, e.g. Shirley Kuo is rendered as *Guo Wan-rong* on one occasion in Chapter 5). Quotations and the titles of Chinese books, articles, newspapers and so on are also provided in *Pinyin* (e.g. *Jingji Ribao*), alongside English translations (e.g. Economic Daily News). In the absence of an established or commonly accepted translation, I provide my own.

-Introduction-
Giving credit where it's due: technocrat leadership and financial reform

Why is it that when we study the high politics of international history we are so often content to focus on the preferences of leaders as causal factors, but when we look at the low politics of day to day domestic policy development we feel obligated to seek out institutional imperatives, social or economic pressures or intrigue? Why is it that the making of war and peace or the birth of a nation are events which seem almost intrinsically tied to the actions of extraordinary individuals, but bank privatization or the construction of an unusually attractive shopping mall are faceless endeavors? Isn't it possible that smart, dedicated, or at least unusual people are *always* responsible for political choice? Could it be that for every Otto von Bismarck, Winston Churchill or Gamal Nasser there are a thousand 'micro-leaders' whose actions, while less spectacular, have just as great an impact on the way we conduct our daily lives?

This is a thesis about the political economy of financial liberalization in Taiwan during the late 1980s, a period of policy change that is poorly understood in the established policy literature.[1] It seeks to address a simple question, with a surprisingly simple answer: Just who or what drove the process of finance reform in Taiwan at this time? Despite the innate complexity of the topic area, the answer is no more obscure or less defensible than attributing Kuomintang 'Taiwanization' to the foresight of past President Chiang Ching-kuo, or attributing many of the abuses of the White Terror period to the politicking of Chiang Kai-shek. In its most condensed and rudimentary form, the argument of this thesis is that *leadership practices matter* when it comes to questions of economic policy change or continuity. This holds even in the highly technical and arcane world of Taiwan financial regulation. In making this claim, I am not arguing that a host of other factors did not also influence policy development in Taiwan during

[1] Taiwan's experience of financial reform in the late 1980s is directly covered in only a few works, and much of it is written from an economics or legal studies perspective. See: Lawrence S. Liu, 'Brave New World of Financial Reform in Taiwan, the Republic of China – Three Waves of Internationalization and Liberalization and Beyond' in *Chinese Yearbook of International Law and Affairs* Vol.8 (1988-89); the Shea and Yang articles in Hugh T. Patrick and Yung Chul Park (eds.), *The Financial Development of Japan, Korea and Taiwan: Growth, Repression, and Liberalization* (New York: Oxford University Press, 1994); and Brian Wallace Semkow, *Taiwan's Financial Markets and Institutions: The Legal and Financial Issues of Deregulation and Internationalization* (Westport: Quorum Books, 1992). Explicitly political science or policy science work is almost non-existent. For some lonely examples which at least broach the topic, see: Tun-jen Cheng, 'Guarding the Commanding Heights: The State as Banker in Taiwan' in Stephan Haggard, Cheng H. Lee and Sylvia Maxfield (eds.), *The Politics of Finance in Developing Countries* (Ithaca: Cornell University Press, 1993); Yun-han Chu, 'Surviving the East Asian Financial Storm: The Political Foundation of Taiwan's Economic Resilience' in T. J. Pempel (ed.), *The Politics of the Asian Economic Crisis* (Ithaca: Cornell University Press, 1999); and Elizabeth Thurbon, 'Two Paths to Financial Liberalization: South Korea and Taiwan' in *The Pacific Review* Vol. 14, No. 2 (2001). There are no Taiwan equivalents for the work on Japanese financial policy produced by writers like James Horne or Frances McCall Rosenbluth.

the watershed years of the late 1980s; factors besides the entrepreneurial activities of the policy elite *were* important. Ultimately, however, it was the ideas and opportunities of Taiwan's technocracy[2] that left the most fingerprints on new policy programs and strategies. Just as Mao Zi-dong's principles of guerilla warfare were instrumental in deciding the outcome of the Chinese civil war, the preferences of Taiwan's senior economic policy-makers dictated the pattern of Taiwan financial reform. This group of elites were ripple-makers in the arena of Taiwan financial policy – even today, millions of people on the island feel the effect of their efforts every time they withdraw money from the bank, buy shares or use a credit card. Largely unacknowledged, these decision-makers defined the character and limits of the contemporary financial system in the Republic of China (RoC – *Zhonghua Minguo*). It is high time we gave credit where it's due!

But whatever the moral force of this plea for recognition, we need more substantive reasons for writing a thesis about the process of financial opening in Taiwan. Why look at Taiwan and financial policy? The answer to this question lies in the historical character of the Taiwan reform experience. Financial liberalization (*jinrong kaifang* or *jinrong ziyouhua*) in Taiwan during the late 1980s was juxtaposed against a record of strong government intervention in all areas of finance. From banking to the stock market to the administration of foreign exchange, the ruling Kuomintang (KMT – *Guomindang*) or Chinese Nationalist Party controlled or meddled in almost every facet of credit allocation. Very few capitalist economies can claim to have had such a strong role for government in such a crucial sector of the domestic economy. And then everything changed. By the early to middle 1990s, Taiwan was fast losing its reputation as a protected market for savings and investment, and steadily acquiring a capacity to compete with the financial service industries of Hong Kong, Tokyo and Singapore. Just how did the Taiwan financial system move from virtual autarky to a largely open market for credit in just over half a decade? This policy shift is particularly intriguing when we consider that it occurred under the auspices of the same political regime that built the original financial system: i.e. the KMT. If financial liberalization involves at least some loss of authority or influence for a political regime (as I would argue it does – see below), then why did the KMT choose to disempower itself in the late 1980s? If, as Stephan Haggard maintains, 'No policy that is seen to weaken the political authority of a particular government is likely to be implemented,'[3] why then did the KMT seek to pursue such a policy? We seem to be faced with the paradoxical situation of a proven monopolist in economic policy embarking on radical reform. How is this possible?

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[2] To use a term first coined by Fischer. See: Frank Fischer, *Technocracy and the Politics of Expertise* (Newbury Park: Sage Publications, 1990), chp. 1.

[3] Stephan Haggard, 'The Politics of Industrialization in the Republic of Korea and Taiwan' in Helen Hughes (ed.), *Achieving Industrialization in East Asia* (Cambridge: Cambridge University Press, 1988), p. 281.

While we have already floated a proximate answer to these questions – financial reform occurred because an entrepreneurial technocracy decided to pick up the reform agenda and run with it – the significance of this position only becomes clear when we consider what doesn't explain the RoC case of financial opening. The standard analytical tools used to illustrate the process of international financial liberalization ultimately give us poor insight into the Taiwan experience. These theories or interpretations may be placed into four main schools: statist analysis, pluralism, the foreign pressures model and the market-driven approach.[4] In brief: statist analysis emphasizes government (especially bureaucratic) power and will as explanatory variables; pluralism emphasizes the influence of big business interests; the foreign pressures model points to the nature of the international system of nation-states; and finally, the market-driven approach emphasizes the diminishing ability of governments to curb market forces over time. While all of these theoretical approaches have *prima facie* relevance for the Taiwanese case of financial reform – and therefore deserve to be taken seriously – none of them is ultimately satisfactory. If we look at the process of reform in exacting detail (an important objective of this thesis), it becomes readily apparent that none of the usual theoretical suspects can adequately explain the timing and method of policy change. It is this inability of the mainstream theories of financial liberalization to explain the Taiwan case that makes an approach emphasizing 'technocrat leadership' so appealing and ultimately necessary. After reviewing the facts, we soon find that to make any sense of financial opening in Taiwan during the late 1980s, we need to talk about proximate decision-makers[5] and the opportunities and constraints they faced.

However, all of this will not be new to your average economic historian. Most economic historians are quite happy to give leadership practices (however defined) strong weighting in the determination of economic policy change. What these writers don't do, however, is theorize such things. By contrast with the historical literature, in this thesis I will attempt to forward a model of technocrat leadership that is generalizable. Starting from the premise that leadership is a *practice* involving idea generation, creative effort, teamwork and opportunism,[6] and then

[4] Leading examples of these four theories include, respectively: Richard O'Brien, *Global Financial Integration: The End of Geography* (London: Pinter Publishers, 1992); Louis W. Pauly, *Opening Financial Markets: Banking Politics on the Pacific Rim* (Ithaca: Cornell University Press, 1988); Frances McCall Rosenbluth, *Financial Politics in Contemporary Japan* (Ithaca: Cornell University Press, 1989); and Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca: Cornell University Press, 1994). For a simple introduction, see: Christopher Hood, *Explaining Economic Policy Reversals* (Buckingham: Open University Press, 1994), chp. 2.

[5] Robert D. Putnam, *The Comparative Study of Political Elites* (Englewood Cliffs, N.J.: Prentice Hall, 1976), chp. 1.

[6] See e.g.: Jameson W. Doig and Erwin C. Hargrove (eds.), *Leadership and Innovation* (Baltimore: John Hopkins University Press, 1987); William H. Riker, *The Art of Political Manipulation* (New Haven: Yale University Press, 1986); Michael D. Cohen and James G. March, *Leadership and Ambiguity*, 2nd ed. (Boston: Harvard Business School Press, 1986); and Norman Frohlich, Joe A. Oppenheimer, and Oran R. Young, *Political Leadership and Collective Goods* (Princeton: Princeton University Press, 1971).

supplementing this with the insights of the literature on party politics and economic policy,[7] I will develop a simple framework of technocrat constraints which suggests a variety of falsifiable outcomes in the process of financial policy change. This feature of the thesis places it firmly in the realm of social science, rather than economic history. It is hoped, however, that I can produce a work of social science in which agency matters just as much as structural imperatives, and in which we can 'take preferences seriously.'[8]

And herein lies the real contribution of this thesis. In the process of relating Taiwan's story of financial liberalization, I will demonstrate that macro-policy effects are *systematically* dependent on the intimate world of group micro-politics. Reminiscent of Congressman Tip O'Neil's reminder that 'all politics is local politics,' we will discover that ultimately the fate of national economies rest in the hands of a select few. It is my contention that if policy researchers are willing to dig deep enough, they will usually find a small assembly of key individuals at the center of policy change, and that frequently it is not just a question of who's in power or where the buck stops. Unfortunately, the tools of political science and policy analysis rarely allow us to get this close, and in practical terms this kind of intimate inquiry is extremely difficult to perform. In the present study, however, I have used theory and research methodology that necessitated 'close-cut' research. A large portion of the research for the thesis was based on interviews with policymakers, industry professionals, academics and politicians in Taiwan. I was able to secure insightful interviews with a number of the actual leaders who are the subject of this study, or with the personal friends and colleagues of these individuals. In total, I talked to around 80-100 people in Taiwan, on and off the record. Aside from oral sources, I also made use of a range of primary and secondary Chinese literatures. Most of this material, including a selection of government reports and several unpublished Masters and Ph.D. theses, are largely unknown to Western scholars. For basic details on the historical record, I relied on a number of local Taiwanese newspapers and magazines. Only a few recent political economy works on Taiwan can claim the same kind of access and attention to detail.[9]

But just as self-praise is ultimately no recommendation, so too we must be wary of the scholar who hesitates in defining his terms. The comments in the preceding paragraphs beg

[7] The classic statement of the position is: Douglas Hibbs Jr., 'Political Parties and Macroeconomic Policy' in *American Political Science Review* Vol. 71, No. 4 (December 1977). Most recently, a small number of scholars have tried to link an understanding of political parties with economic reform. See e.g.: Javier Corrales, 'Presidents, Ruling Parties and Party Rules' in *Comparative Politics* Vol. 32, No. 2 (January 2000).

[8] Andrew Moravcsik, 'Taking Preferences Seriously: A Liberal Theory of International Politics' in *International Organization* Vol. 51, No. 4 (Autumn 1997).

[9] See for example: Cheng-tian Kuo, *Global Competitiveness and Industrial Growth in Taiwan and the Philippines* (Pittsburgh: University of Pittsburgh Press, 1995); Gerald A. McBeath, *Wealth and Freedom: Taiwan's New Political Economy* (Aldershot: Ashgate Press, 1998); and Gregory W. Noble, *Collective Action in East Asia: How Ruling Parties Shape Industrial Policy* (Ithaca: Cornell University Press, 1998).

elaboration of some key concepts. A term we will see repeatedly throughout this thesis is the 'financial system of Taiwan,' or words to that effect. Just what do we mean by this phrase? In the simplest of conceptions, 'finance' refers to the provision and use of unconsumed income. It is that proportion of aggregate income which households save rather than spend on final-use goods and services, and which businesses subsequently borrow to build up or maintain their stock of equipment, production facilities, human resources and real estate – a tangible reserve otherwise know as 'capital.' A 'financial system' or 'financial sector' is the sum of all the institutional arrangements governing the provision and allocation of unconsumed income. It is a component of the broader economic system which also includes the government sector, private consumption and net export activity.[10]

Over the period of relevance to this thesis, the financial system in Taiwan was composed of two basic types of financial institution (see Table Intro.1 for an overview).[11] Intermediaries were the first type. Intermediaries issue indirect financial instruments like deposits, trust and insurance contracts or bank debentures, and in turn lend or invest the accumulated funds. Among Taiwan's leading intermediaries over the time in question we can include domestic commercial banks, branch offices of foreign commercial banks, small-business banks, credit cooperatives, credit departments of industry associations, investment and trust companies, the postal savings system, insurance companies and venture capital firms. Non-intermediaries were the second broad category of financial institution in Taiwan. The function of non-intermediaries is to facilitate the sale of securities issued by ultimate borrowers (i.e. publicly issued companies), such as shares and bonds, to ultimate lenders (i.e. individual and corporate investors). Among Taiwan's leading non-intermediaries we can count bills finance companies, securities firms (including brokers, dealers, underwriters and integrated securities houses), securities finance companies and securities investment trust enterprises. Financial intermediaries supplied in excess of half of all corporate funding in Taiwan in the late 1980s, while non-intermediaries supplied merely a fifth (details in chapter 1). The remainder was taken-up by another breed of institution...

Taiwan's informal credit markets – the curb or 'underground markets' – were home to a set of financial institutions which were decidedly less stable but much more flexible than their legal counterparts. Among these twilight enterprises we can include moneylenders, pawnbrokers, rotating credit rounds, various underground investment companies and unofficial credit departments of erstwhile legitimate companies. Such operations had no established organization and were highly fragmented, but according to most estimates played a crucial role in the overall allocation of credit in Taiwan (upwards of 25%). Reflecting this important contribution, the

[10] Susan Strange, *States and Markets* (London: Pinter Publishers, 1988), p. 88; and Charles R. Geisst, *A Guide to the Financial Markets*, 2nd ed. (New York: St Martin's Press, 1989), chp. 1.
[11] I have borrowed this taxonomy from: Semkow, *Taiwan's Financial Markets and Institutions*, fn. 1, chp. 4.

authorities usually refrained from actively suppressing the informal system, and kept a watchful eye on its interaction with the formal system.[12]

TABLE Intro.1 The financial system in Taiwan, institutional overview

Financial Intermediaries - Banks and Others	Non-intermediaries & Informal Institutions	Administrative Structure of the Financial System
Banks	*Non-intermediaries*	*Supervisory Agencies*
Domestic commercial banks.	Bills finance companies	Executive Yuan.
Branch offices of foreign commercial banks.	Securities firms (brokers, dealers, underwriters).	Ministry of Finance.
		Central Bank of China.
Small to medium business banks.	Securities finance companies.	Taiwan Stock Exchange.
	Securities investment trust enterprises.	Taipei Dealers Association.
		Central Deposit Insurance Corporation, etc.
Others (non-banks)		
Credit cooperatives.	*Informal Institutions*	
Credit departments of industry associations.	Moneylenders.	*Finance Laws*
	Pawnbrokers.	National Bank Law.
Investment and trust companies.	Rotating credit rounds.	Statute for the Administration of Foreign Exchange.
	Unofficial credit departments.	
Postal savings system.	Underground investment companies.	Securities Exchange Law, etc.
Insurance companies.		
Venture capital firms.		

Source: Sebastien Dessus, Jia-dong Shea and Mau-shan Shi, *Chinese Taipei: The Origins of the Economic 'Miracle'* (Paris: Development Centre of the OECD, 1995), p. 90 with modifications and additions.

And finally, consider the administrative structure of Taiwan's financial system. All the financial institutions of Taiwan mentioned above were governed by a series of official regulators and laws. Among the key supervisory agencies we can include: the Executive Yuan, the Ministry of Finance, the Central Bank of China and the Securities and Exchange Commission. In addition to these formal regulators, a number of quasi-public sector agencies also performed regulatory functions. Some of the more important ones were the Taiwan Stock Exchange Corporation, the Taipei Dealers Association and the Central Deposit Insurance Corporation. Among the major laws governing the Taiwanese financial system we can include: the National Bank Law, the Statute for the Administration of Foreign Exchange and the Securities Exchange Law. Other

[12] Sebastien Dessus, Jia-dong Shea and Mau-shan Shi, *Chinese Taipei: The Origins of the Economic 'Miracle'* (Paris: Development Centre of the OECD, 1995), p. 94-95.

laws of indirect importance for local finance included the Company Law of the RoC and the Central Bank of China Act.[13]

Other terms that will feature strongly in this thesis include 'financial reform' or 'financial liberalization.' Just what is meant by these particular phrases? Financial liberalization involves reformulating the basic conditions of financial repression, as first detailed by Ronald McKinnon and Edward Shaw in the early 1970s. McKinnon and Shaw juxtaposed two ideal types of financial system: a repressed financial system and a liberal one. In a liberal financial system, the demand for and supply of funds dictates how unconsumed income is utilized. By contrast, in a repressed financial system, the state enforces artificially low interest rates and is drawn into the process of rationing funds (either willingly or unwillingly), with a resulting drop in systemic efficiency.[14] For McKinnon and Shaw, the liberalization, deregulation, reform or opening of financial markets ultimately refers to the shift in decision-making power over the allocation of funds from state agencies in a repressed financial system to the market in a liberal framework for finance. In the final analysis, the key issue for these economists is *who* decides where and how unconsumed income is utilized. Do state agents or market participants have the ultimate authority to make decisions about savings and investment? To the extent that countries empower the state to make these choices, their financial systems can be described as 'repressed.' To the extent that they give allocation powers to private individuals or companies through the market, their financial systems are 'liberal.' Various points in between these contrasting ideals we might call *degrees* of financial openness or liberalization.

Now despite the fact that the above may seem too obvious to warrant elaboration, it is not without its detractors. It assumes at least two things that are considered controversial by some analysts of financial policy change: first, that a regulatory framework of some description will be required to support *either* a repressed *or* a liberal financial system; and second, that liberalization, reform or deregulation do not necessarily involve eradicating legal strictures as the terms might seem to imply.[15] A case can be made, for example, that financial liberalization and deregulation have quite distinct meanings. Steve Vogel argues that liberalization refers to the introduction of more competition within a market, while deregulation refers to the reduction or elimination of government regulations. He is adamant in making this distinction because in his view the latter term is actually a misnomer: deregulation has been closely associated with what

[13] Brian Wallace Semkow, *Taiwan's Capital Market Reform: The Financial and Legal Issues* (Oxford: Clarendon Press, 1994), p. 23-30.

[14] Ronald I. McKinnon, *The Order of Economic Liberalization: Financial Control in the Transition to a Market Economy* (Baltimore: John Hopkins University Press, 1991), chp. 1. See also: Ronald McKinnon, *Money and Capital in Economic Development* (Washington: The Brookings Institute, 1973); and Edward Shaw, *Financial Deepening in Economic Development* (New York: Oxford University Press, 1973).

[15] Roger Noll, 'The Political Foundations of Regulatory Policy' in K. McCubbins and T. Sullivan (eds.), *Congress* (Cambridge: Cambridge University Press, 1987), p. 464.

Vogel and others call 're-regulation,' the reformation of old rules and the creation of new ones.[16] While Vogel's distinction may represent a more accurate usage of these terms, in practice the activities of liberalization, deregulation and reregulation, if they are not uniformly synonymous, are usually linked. The analytical separation of the concepts assumes that there are universal measures for the 'amount' of regulation shaping financial systems. In reality, it is impossible to find clean-slate examples of 'nil regulation' or 'full regulation' against which we can compare various *amounts* of deregulation and reregulation. There is always a body of regulatory provisions to contend with – it is the quality of regulations that counts, not their quantity. Some regulatory frameworks for finance empower the state to make allocation decisions, others the market. It's that simple.

Finally, some brief words on the structure of the thesis. Chapter 1 presents an overview of the Taiwan experience of financial reform in the late 1980s, and then compares this historical record to the theoretical debate on financial liberalization. A case for a technocrat leadership approach to financial reform is forwarded and the case studies of the thesis introduced. Chapter 2 is a 'nuts and bolts' chapter that outlines the elements of RoC financial reform – i.e. the economic technocrats and the ruling KMT. This chapter also includes a brief introduction to the general process of financial policy change in Taiwan. Chapters 3 to 5 are the core case studies of the thesis. Presented in chronological and processional order, these chapters review and analyze data on the three main episodes of financial reform in Taiwan as they unfolded over the course of the 1980s and beyond – reform of securities, the foreign exchange system and banking, respectively. The conclusion of the thesis takes us beyond the immediate *raison d'être* of the project to briefly consider why policy change appeared to stagnate over the course of the 1990s.

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16 Steven K. Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries* (Ithaca: Cornell University Press, 1996). p. 3.

-Chapter 1-
Financial reform in Taiwan and theoretical approaches to liberalization

Introduction

After decades of operating one of the most tightly controlled capitalist economies in the world, in the late 1980s the KMT regime commenced deregulation of Taiwan's financial sector. Reform was introduced in three consecutive waves of legal amendment, including passage of new laws for the foreign exchange system, securities and banking in 1987, 1988 and 1989 respectively.[1] In many ways these three waves of reform represented the start of a whole new era of economic policy for Taiwan, foreshadowing a decade of respectable growth rates through the 1990s. They were as important for the course of RoC economic development as concurrent initiatives in the political sphere were for Taiwan's democratization.

The key question or puzzle for this dissertation concerns this dramatic historical shift in financial policy of the late 1980s. Liberalization of the financial system was juxtaposed against a 40-year history of strong government intervention in all areas of finance. In the period prior to 1987, for example, state agencies owned and directly operated the lion's share of Taiwan's banks, securities houses, bills finance institutions, insurance companies, venture capital firms – in fact just about anything that facilitated exchange between those with funds to spare and those in need of funds to invest. By the early 1990s, however, there were more than a dozen new private banks operating alongside the government owned institutions, and where there had once existed fewer than 20 securities houses, there were now more than 300. Financial opening implied the elimination of habits of administration that were so firmly entrenched in the thinking of government officials and market participants alike that as late as 1986, little room for adjustment seemed possible. Why, come 1987, did the KMT regime begin to change its mind? Why did the ruling party decide that from 1987 on, the state would begin to release its iron grip on 'the commanding heights of the economy'?[2]

In this chapter I will begin by detailing the magnitude and significance of the shift from old to new financial administration in Taiwan. With this outcome as our starting point, I will then consider possible explanations of the late 1980s reform movement. Among the established theories that dominate much of the political economy debate about financial liberalization we can include the market-driven approach, statist analysis, pluralism, and the foreign pressures model. The details of each of these theories will be elaborated, and their general arguments subjected to a test. We will see that none of the established theories of financial reform can

[1] The 'waves' metaphor is introduced in: Lawrence S. Liu, 'Brave New World of Financial Reform in Taiwan, the Republic of China – Three Waves of Internationalization and Liberalization and Beyond' in *Chinese Yearbook of International Law and Affairs* Vol. 8 (1988-89).

provide us with an adequate explanation of the Taiwan case. We will then turn to an alternative theory of financial policy change based on interaction between the leadership efforts of technocrats and party politics. This theory of technocrat leadership stems from an amalgamation of some of the softer literature on leadership in public policy with the work on political parties and economic policy choice.

1. Financial reform in Taiwan: before and after the late 1980s

It is fair to suggest, after Robert Wade, that the post-war history of financial administration on Taiwan probably had more in common with the way communist countries managed their financial systems than with capitalist Western nations.[3] The KMT regime firmly controlled almost every facet of the local financial system, and meddled in those parts that ostensibly were left free. RoC finance was, to use the language of McKinnon and Shaw, comprehensively repressed.[4] In the period prior to the late 1980s, state agencies were dominant players in every major market on the island – banking, the primary and secondary markets for securities instruments, the foreign exchange market and the money market. As suggested in the introduction to this chapter, the state owned and directly operated the great bulk of RoC financial institutions operating in these markets, from the commercial banks to venture capital firms. In addition to direct state ownership of institutions, prices (i.e. interest rates) were fixed, the range of financial instruments was narrowly restricted, competition faced rigid geographical controls, and avenues for industry entry were tightly closed. While the aggregate level of savings and investment does not seem to have been harmed by the high level of repression (see Table 1.1),[5] this was a financial system that economic planners in the former Eastern Bloc would have been familiar with.[6]

But then came the financial reform movement of the late 1980s, and everything changed. Into the 1990s, a number of serious comparative studies placed the Taiwanese financial system as among the most open in the East Asian region.[7] Anecdotal reports from foreign financiers

Tun-jen Cheng, 'Guarding the Commanding Heights: The State as Banker in Taiwan' in Stephan Haggard, Cheng H. Lee and Sylvia Maxfield (eds.), *The Politics of Finance in Developing Countries* (Ithaca: Cornell University Press, 1993).

See: Robert Wade, 'East Asian Financial Systems as a Challenge to Economics: Lessons from Taiwan' in *California Management Review* Vol. 27 (Summer 1985), p. 114.

Ronald I. McKinnon, *The Order of Economic Liberalization: Financial Control in the Transition to a Market Economy* (Baltimore: John Hopkins University Press, 1991), chp.1.

NB.: I make no claim for the level of performance of various policy frameworks in this thesis. My interest is in explaining policy change and continuity, rather than trying to demonstrate which policies work the best. Table 1.1 is included simply for reference purposes.

By way of comparison, see: David Lipton and Jeffrey Sachs, 'Creating a Market Economy in Eastern Europe: The Case of Poland' in *Brookings Papers on Economic Activity* No. 1 (1990).

See the Taiwan sections in: Bryan T. Johnson, Kim R. Holmes and Melanie Kirkpatrick, *1999 Index of Economic Freedom* (New York: Heritage Foundation and The Wall Street Journal, 1999); James Gwartney and Robert Lawson, *Economic Freedom of the World 1997* (Vancouver: Fraser Institute, 1997); and James R. Barth, Gerard Caprio Jr., and Ross Levine, 'Banking Systems Around the Globe: Do Regulation and Ownership Affect Performance and Stability?' research paper prepared for the World Bank, Working Paper No. 2325 (April 2000), available online at http://econ.worldbank.org/ [web page of the economic research division of the World Bank] – viewed on 5 October 2001.

operating in and out of Taiwan confirmed these conclusions.[8] With the exception of the city-states of Hong Kong and Singapore (arguably atypical cases that prove the rule), Taiwan was fast developing a reputation as a beacon of liberal financial administration in a sea of more insular regimes. By virtually every measure, the financial system in Taiwan was more open after the reform push than before it. Interest rate controls were lifted, foreign financial institutions gained market access, regional monopolies were abandoned, a plethora of new financial instruments (from convertible bonds to credit cards) were allowed for the first time and entry reform was pursued in all of the key financial markets. While it is true that Taiwan still had some way to go to be considered a 'free' market for capital, in the wake of the late 80's reform push comparisons with the financial systems of the (old) communist bloc were unthinkable.

TABLE 1.1 Taiwan savings and investment ratios (as % of GNP), 1950s-1990s

Period	Savings	Investment
1956-1962	11.1	18.0
1963-1973	24.3	23.9
1974-1978	31.9	31.7
1979-1983	32.2	29.0
1984-1988	35.7	20.2
1989-1992	29.5	23.1

Notes: Periods are selected to dampen the effects of major shifts in economic policy (e.g. the shift to export orientated industrialization in the early 1960s), the oil shocks (1972-73, 1981-82), and growth spurts after recession (e.g. late 1970s, late 1980s).
Sources: Hang-sheng Cheng, 'Financial Policy and Reform in Taiwan, China' in Hang-sheng Cheng (ed.), *Financial Policy and Reform in Pacific Basin Countries* (Lexington: DC Heath & Company, 1986), p. 145; and *Taiwan Statistical Data Book, 1996* (Taipei: Council for Economic Planning and Development, 1996).

Just how did so radical a policy shift come about, and in such a short space of time? The regulatory realignment is particularly intriguing given the fact that reform occurred against a background of political continuity. Substantial evidence from North America, Europe, Latin America and Australasia suggests that financial liberalization tends to follow political change, or more specifically, change in governing parties.[9] In the United States and Great Britain, for example, the ascendancy of Right-wing political parties saw the introduction of comprehensive reforms in the early to mid 1980s. Paradoxically, at around the same time, in Australia and New

[8] Various interviews with foreign bankers in Taipei, 1996.
[9] The literature here is extensive. Some examples will suffice: Edward L. Gibson, 'The Populist Road to Market Reform: Policy and Electoral Coalitions in Mexico and Argentina' in *World Politics* Vol. 49, No. 3 (April 1997); Jacques Melitz, 'Financial Deregulation in France' in *European Economic Review* Vol. 34 (1990); Herman Schwartz, 'Small States in Big Trouble: State Reorganization in Australia, Denmark, New Zealand and Sweden in the 1980s' in *World Politics* Vol. 46, No. 4 (July 1994); Suiwah Leung, 'Financial Liberalization in Australia and New Zealand' in Sylvia Ostry (ed.), *Authority and Academic Scribblers* (San Francisco: ICS Press, 1991).

Zealand reform followed the ascendancy of social democratic parties. The Taiwanese experience of reform, however, presents a rare example of financial opening under continuous rule by the same political party – i.e. the KMT.[10] While financial reform *was* coincident with democratization of the Taiwanese political system, during the period in question the KMT at no point appeared to be under threat from opposition forces. Not until the late 1990s would the 50-year rule of the KMT face credible competition in domestic politics. Why would a governing party with no fundamental risk to its continued rule choose a radical policy option?

The weight of this question is all the more significant when we consider the character of the ruling party that presided over reform. The political economy work on RoC industrial policy by writers such as Alice Amsden, Robert Wade and Chalmers Johnson[11] tells us that the KMT was far from what we might call 'naturally disposed' toward economic liberalization. These writers argue that the KMT regime was heavy-handed in just about every area of national production and exchange, with upstream suppliers coming in for special attention. Aside from the usual assortment of public interest interventions in areas such as health and education, the KMT regime's list of occupied industries also included: petrochemicals and plastics, mining and mineral processing, transport and communications, organic chemicals and pharmaceuticals, construction, electronic and print media, trade and shipping, agriculture, shipbuilding, steel and iron production, alcohol and tobacco, the automotive industry, electricity, textiles and so on. Although some of these industry areas were, like finance, subject to various reform initiatives after the mid 1980s, many of them remained under state control up to the end of KMT rule in 2000. In short, the KMT was a committed monopolist in the conduct of economic and commercial policy. Why, then, in the late 1980s did it choose to liberalize such a crucial area of economic administration as finance?

But before we move on to answer these questions, we are obliged to establish beyond reasonable doubt that regulatory change *did in fact occur*. This is an important task because casual comparisons with the degree of financial 'openness' in advanced industrial countries

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[10] Among the other outliers we can probably include Malaysia and India, although the former case never faced the level of financial repression extant in pre-reform Taiwan, and the latter case only saw financial opening after the dominant position of the ruling Congress Party had been critically challenged (early 1990s). For India, see: Kunal Sen and Rajendra R. Vaidya, *Financial Sector Reforms in India, 1991-94, Economics Division Working Papers, South Asia 96/5* (Canberra: National Centre for Development Studies, Australian National University, 1996); and Deepak Lal, 'India and China: Contrasts in Economic Liberalization?' in *World Development* Vol. 23, No. 9 (1995). For Malaysia, see: Natasha Hamilton-Hart, 'States and Capital Mobility: Indonesia, Malaysia and Singapore in the Asian Region' unpublished Ph.D. manuscript, Cornell University (1999), various sections.

[11] See especially: Alice H. Amsden, 'Taiwan's Economic History: A Case of Etatisme and a Challenge to Dependency Theory' in *Modern China*, Vol. 5, No. 3 (July 1979); Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton, New Jersey: Princeton University Press, 1990); and Chalmers Johnson, 'Political Institutions and Economic Performance: The Government-Business Relationship in Japan, South Korea and Taiwan' in Frederic C. Deyo (ed.), *The Political Economy of the New Asian Industrialism* (Ithaca: Cornell University Press, 1987).

might suggest that reform was neither comprehensive nor permanent.[12] Moreover, it is also possible that the financial reform effort was merely a clever public relations campaign; it is certainly true that many of Taiwan's earlier attempts to liberalize the financial system were of this character.[13] As briefly mentioned in the introduction, the main episodes of financial reform in Taiwan during the late 1980s were centered on three discernible 'waves' of legal amendment; new laws for the foreign exchange system, securities and banking were progressively introduced in 1987, 1988 and 1989 respectively. The focus of these reform efforts were three key statutes governing the financial sector: i.e. the Statute for the Administration of Foreign Exchange, the Securities Exchange Law and the National Bank Law. Soon after the amendment of these legal documents, significant and lasting changes in the flow of funds and the conduct of financial business on Taiwan became apparent. In both legal and substantive terms, the before and after picture across the three main areas of Taiwanese finance is quite striking. In the discussion that follows, we will consider these changes in some depth. It will be shown that change was real, not mere window-dressing (for a brief overview, see Table 1.2).

To begin with, consider the foreign exchange system. Under the original Statute for the Administration of Foreign Exchange (SAFE – *Guanli Waihui Tiaoli*),[14] all private foreign exchange (forex) dealings were prohibited in principle, with exceptions made for a small list of key transactions. Chief among these exceptions were movements of currency arising from exports, or the import of goods required for export production. Foreign exchange dealings on the capital account were mostly forbidden. All forex transactions were subject to a defacto clearance system administered by the Central Bank of China. Exchange controls buttressed a fixed exchange rate mechanism that saw the New Taiwan dollar (NT$ – *Xin Taibi*) pegged to the US dollar.[15] As a partial result of these restrictions, Taiwan's balance of payments tended to exhibit two features. To begin with, prior to the late 1980s there was a structural tendency for the trade account to record large surpluses. Taiwan's trade profile was extraordinary by international standards. In 1986, the RoC's trade surplus hit an all-time high at over 20% of GNP. In the years between 1983 and the end of the decade, the surplus ran at an average of 13% per year.[16] The other distinctive feature of Taiwan's balance of payments was the uncontrollable expansion of the Central Bank's forex reserves. At the end of the 1970s, the

[12] See for example: Brian Wallace Semkow, 'Financial Reform in Taiwan' in *Butterworths Journal of International Banking and Financial Law* Vol. 7 (June 1992), p. 274.

[13] See e.g.: *Far Eastern Economic Review* (23 April 1976), p. 117. Includes critical review of changes to the National Bank Law brought down in late 1975.

[14] *Guanli Waihui Tiaoli* [Statute for the Administration of Foreign Exchange] (Taipei: Central Bank of China, 1970).

[15] From: *Zhonghua Minguo Zhongyang Yinhang zhi Zhidu yu Gongneng* (Taipei: Central Bank of China, 1992); p. 98-108; or *Central Bank of China: System and Functions* [official translation] (Taipei: Central Bank of China, 1996), chp. 8, sec. 1.

[16] In comparative terms, only a small number of OPEC countries have experienced surpluses as large or as long as those recorded by Taiwan before the late 1980s. Wing Thye Woo and Liang-Yn Liu, 'Taiwan's Persistent Trade Surpluses: The Role of Underdeveloped Financial Markets' in Joel D. Aberbach, David Dollar and Kenneth L. Sokoloff (eds.), *The Role of the State in Taiwan's Development* (Armonk: M.E. Sharpe, 1994).

Central Bank's reserves stood at US$1.5 billion; by 1984, the tally had increased tenfold, to US$15.6 billion. Thereafter, in the years 1985, 1986 and 1987 the Bank nearly doubled its forex holdings annually – US$23 billion, US$46 billion and US$77 billion respectively.[17] The flip side of these figures was unspectacular fluctuations on the capital account. With the bulk of incoming forex retained as reserves by the Central Bank, capital exports were insignificant. Officially approved outward direct investment by Taiwanese citizens was less than US$1 billion for the entire period between 1952 and 1985.[18]

After the reform push of July 1987, the central policy provisions of the foreign exchange framework became much more flexible. The inclusion of article 26-1 in the foreign exchange law authorized the government to suspend the application of core SAFE articles 6.1, 7, 13 and 17,[19] which in combination outlawed any private right to hold, use or trade foreign exchange.[20] The most immediate effect of this regulatory shift was a sharp turnaround in the accumulation of foreign currency assets by the Central Bank. No longer a clearing-house for forex, the CBC went from absorbing an additional US$28 billion in 1987 to off-loading around US$1.5 billion in 1988. As noted above, in the three years to 1987 the Central Bank nearly doubled its foreign exchange holdings annually, ending with a total of US$77 billion. For the following three years, however, the Central Bank's accumulated forex remained relatively stable around US$75 billion. The flip side of this turnaround was an increase in foreign asset holdings by RoC citizens. Direct investment abroad increased at a phenomenal rate. In the six years to 1987 outgoing direct investment averaged a mere US$60 million per year. For the following six years, by contrast, the equivalent annual figure was US$4 billion.[21] In time, the Central Bank's reduced capacity to determine the direction of the NT dollar (which appreciated from US$1:NT$40 in the mid 1980s to an all-time high of US$1:NT$26 in 1989) also meant that the trade surplus subsided. From the giddy heights of over 20% of GNP in 1986, by 1989 the trade balance had decreased to 10% of GNP, and then 7% by 1991. Two years later in 1993, a plateau was reached with the surplus 'stable' at around 3% of GNP.[22]

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[17] *Taiwan Statistical Data Book, 1996* (Taipei: Council for Economic Planning and Development, 1996), p. 4.

[18] *Tongji Yongbao* [Statistics on Overseas and Foreign Investment, Outward Investment, etc.] (Taipei: Investment Commission, Ministry of Economic Affairs, 1996), p. 1-2.

[19] Article 6.1 covers the compulsory reporting system for foreign exchange earnings and debt. Article 7 concerns the compulsory surrender or sale of forex earnings. Article 13 concerns the compulsory purchase of forex by the CBC to meet foreign payment obligations. And article 17 concerns the compulsory repurchase or resale of forex to the CBC or appointed banks. *Guanli Waihui Tiaoli* [Statute for the Administration of Foreign Exchange] (Taipei: Central Bank of China, 1987), art. 6.1, 7, 13, & 17.

[20] C.V. Chen, 'Legal Perspectives of the RoC's Economic Development' paper presented to the Second International Symposium on Finance, Trade and Investment in the Pacific Rim Region, Hong Kong (19-22 February 1989), p. 4.

[21] *Taiwan Statistical Data Book, 1996*, fn. 17, p. 4 & 181-184.

[22] And remained at this level through the end of the 1990s. Calculated from figures in *Taiwan Statistical Data Book, 1996*, fn. 17, p. 1-4.

The second wave of financial reform in Taiwan during the late 1980s was securities liberalization.[23] Under the original Securities Exchange Law (SEL – *Zhengquan Jiaoyi Fa*),[24] approval procedures for the issuance and listing of securities instruments were painfully slow, restrictive and unpredictable. The SEL provided for the registration and review of publicly issued *companies* while in most countries it has been common practice to regulate the actual offering and listing of *securities*. This gave the RoC Securities Exchange Commission onerous screening powers, and placed an unreasonable burden of proof on applicant companies. Secondary markets were segregated and tightly controlled. A strict demarcation of securities firms between underwriters, brokers and dealers was enforced, together with a freeze on firm licenses.[25] This regulatory framework emasculated the local securities sector. One survey of the funding of RoC corporations in the years 1976-1989 reveals: around 56% of funds acquired by the business sector were supplied by formal financial institutions (banks, etc.), around 25% of funds were supplied through the curb market, and just under 20% of corporate funds came from the money and securities markets (roughly 9% and 11% respectively).[26] As of 1987, only some 330 companies were publicly issued. In the same year, outstanding corporate bond issues came to a grand total of 33, with a face value of just NT$8 billion (US$280 million).[27] While the primary markets were underutilized, the island's main secondary market, the Taiwan Stock Exchange, regularly underwent growth cycles that saw the TSE index gain or lose more than half of its value in just 12 months. In some years shares changed hands up to five times, in others much less than 0.5. Trading occurred on an incredibly thin base of listings. In 1985 the total number of listed companies on the TSE was just 127, with 296 stock issues.[28]

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[23] Some brief definitional points are called for at the start of this section. Securities are those debt and equity instruments (i.e. various types of stocks, bonds and derivatives) issued by companies with maturities of 12 months or more. Primary markets are those in which securities are issued, or 'sold,' to first buyers, while secondary markets are those in which securities are traded. An issued company, or publicly issued company, is one which has issued securities instruments to raise capital, while a listed company is one which has moved to have these instruments registered on the secondary markets for trading. John O.E. Clark, *Dictionary of Banking and Finance Terms* (St. Leonards: Prospect Media, 1999).

[24] *Zhengquan Jiaoyi Fa* [Securities Exchange Law] (Taipei: Securities Exchange Commission, Ministry of Economic Affairs, 1968).

[25] See: Paul S.P. Hsu and Lawrence S. Liu, 'The Transformation of the Securities Market in Taiwan, the Republic of China' in *The Columbia Journal of Transnational Law*, Vol. 27 (1988); and Lawrence Shao-liang Liu, 'Recent Developments: Survey of Major Commercial Law Developments in the Republic of China, 1987-1988' in *Chinese Yearbook of International Law and Affairs* Vol. 7 (1987-1988).

[26] Ya-Hwei Yang, Shyuan-Yi Shiau, Wen-Jeng Kuo, Lee-Rong Wang and Meng-Cheng Liu, *The Development of Small and Medium-Sized Enterprises in the Republic of China, Volume 3, The Financing and Marketing Ability of Taiwan's SMEs* (Taipei: Pristine Communications, 1995), p. 27-29.

[27] *TSE Fact Book, 1995* (Taipei: Taiwan Stock Exchange, 1996), p. 51; and *Caizheng Tongji Nianbao, Minguo 84 Nian* [Yearbook of Financial Statistics of the Republic of China, 1995] (Taipei: Department of Statistics, Ministry of Finance, 1995), p. 298-299.

[28] This figure represents less than a third of the companies on the South Korean exchange in the same year, even though Taiwan's level of per capita income was considerably higher than Korea's. Various statistics and observations from: Anthony Rowley, *Asian Stockmarkets: The Inside Story* (Hong Kong: Far Eastern Economic Review 1987); Brian W. Semkow, 'A Synopsis of Current Financial Deregulation and Internationalization of Financial Markets and Institutions in Taiwan' in *Journal of International Banking Law* Vol. 6, No. 9 (1991); and *Taiwan Zhengquan Jiaoyisuo Zhengquan Tongji Ziliao, Minguo 84 Nian* [Taiwan Stock Exchange Statistical Data, 1995] (Taipei: Taiwan Stock Exchange, 1996), p. 2-3.

TABLE 1.2 Major changes in Taiwan's 3 waves of financial reform, late 1980s

Relevant Law	Key Regulatory Changes	Economic Effects
Amended Statute for the Administration of Foreign Exchange. Intrd: July 1987.	Restrictions on right to hold and trade forex suspended, most cross-boarder remittances permitted in principle.	Leveling-off of the Central Bank of China's foreign reserves, increase in private foreign asset holdings.
Amended Securities Exchange Law. Introduced: January 1988.	Offering and listing simplified, new disclosure rules, new securities company licenses permitted, and greater powers.	More publicly issued companies, more listings, radical increase in the number of securities companies.
Amended National Bank Law. Introduced: July 1989.	New private commercial banks permitted, scope and powers of financial institutions extended, interest rates liberalized.	15 new commercial banks est. 1991, deposit/loan margins decreased, a range of new financial products intrd.

Sources: Various, including Brian Wallace Semkow, 'Financial Reform in Taiwan' in *Butterworths Journal of International Banking and Financial Law* Vol. 7 (June 1992); and Brian W. Semkow, 'A Synopsis of Current Financial Deregulation and Internationalization of Financial Markets and Institutions in Taiwan' in *Journal of International Banking Law* Vol. 6, No. 9 (1991).

However, with amendment of the SEL in January 1988,[29] a more open regulatory environment for securities emerged. The process of offering and listing was substantially simplified: an *ex ante* registration system was introduced so that most new issues by public companies were effective 30 days after notifying the Securities Exchange Commission. Although the regulatory onus of the listing process remained intact, the discretion of the Securities Commission was substantially reduced and the entire listing process expedited with the introduction of more transparent and consistent rules for disclosure. The amended legal framework also expanded the business powers of securities firms, and allowed the entry of new companies into the securities industry.[30] Following these moves, more mature and inclusive securities markets gradually began to develop in Taiwan. The number of publicly issued companies skyrocketed: from 339 in 1987, to 500 in 1989, and 947 two years later. By 1995, close to 1,500 companies had issued shares. Listed companies grew at a slower pace, but the trend toward greater participation is clear. By 1993, twice as many companies had listed on the Taiwan Stock Exchange as in 1987 (from 141 to 285). Even the sluggish bond market took off eventually, although it was well into the second half of the 1990s before most companies were willing to experiment with these instruments. On the supply side, the number of licenses

[29] *Zhengquan Jiaoyi Fa* [Securities Exchange Law] (Taipei: Securities Exchange Commission, Ministry of Finance, 1988).
[30] Brian Wallace Semkow, *Taiwan's Capital Market Reform: The Financial and Legal Issues* (Oxford: Clarendon Press, 1994), chp. 5, 6 and 7, various sections; and *SEC Annual Report, 1989* (Taipei: Security and Exchange Commission, Ministry of Finance, 1990), p. 7-10.

granted to new securities companies also expanded. From just 28 brokers in 1987 to an all-time high of 373 in 1990, sectoral growth was among the fastest Taiwan had ever experienced. The background to many of these improvements, however, was continued volatility in the stock market. Between 1986 and 1990, the Taiex grew sporadically from 2,135 points to an all-time high of 12,495 points, before plunging dramatically to 2,560 points in late 1990. Into the mid 1990s, however, with improvements in market fundamentals, the stock market gradually began to stabilize. By this time, it was questionable whether the 'casino' label used by so many commentators in the past could still be said to apply.[31]

Taiwan's third main wave of financial reform – bank opening – took place in mid 1989. Like the early forex and securities laws, the old National Bank Law (NBL – *Zhonghua Minguo Yinhangfa*) was more concerned with constraining markets than with cultivating their development.[32] Jointly administered by the Ministry of Finance and the Central Bank, the National Bank Law contained a blanket prohibition on new banks and specified state agencies as the legal custodian of a range of financial institutions. A host of other restrictions applied to banking practice: interest rates were subject to rigid controls, accounts managers were held criminally liable for non-performing loans, and a vast range of business operations from credit cards to trust services were simply forbidden.[33] The effects of this regulatory environment were predictable enough. To begin with, fully 12 of the 16 commercial banks in Taiwan were state-owned, including the island's four biggest banking operations.[34] Moreover, the so-called 'private' banks were really not so private. Bureaucrats or politicians were on the boards of all these institutions, and their categorization as private had more to do with public relations than with who directed bank policy.[35] Second, the business conduct of all banks was uniformly

[31] Kui-ke Wu, 'The Securities Business in Taiwan: Back to Basics' in *China Post* (30 September 1996), p. 1; *SEC Annual Report, 1989* (Taipei: Securities Exchange Commission, Ministry of Finance, 1990), p. 79; *RoC Securities Market Annual, 1993* (Taipei: Institute of Securities and Futures Markets Development, 1993), p. 30-31; *Taiwan Zhengquan Jiaoyisuo Zhengquan Tongji Ziliao, Minguo 84 Nian* [Taiwan Stock Exchange Statistical Data, 1995], fn. 28, p. 3; and Daniel Yu, 'Why Taiwan Investors are Betting on Bonds' in *Asiamoney* Vol. 7, No. 6 (July-August 1996).

[32] The National Bank Law was originally promulgated in March 1931 on Mainland China. By 1989 it had been amended 7 times. Most of these amendments were regulatory adjustments and variations on the pre-established theme of 'control.' *Zhonghua Minguo Yinhangfa* [Bank Law of the Republic of China] (Taipei: Bureau of Monetary Affairs, Ministry of Finance, 1985).

[33] Liu, 'Brave New World of Financial Reform in Taiwan, the Republic of China,' fn. 1, p. 195-201; *Financial Market Integration in Chinese Taipei* (Taipei: Bureau of Monetary Affairs, Ministry of Finance, 1995), various sections, chp. 1-5; and Susan S. Chang, *The Evolution and Reform of the Financial System in the Republic of China* (Taipei: Bureau of Monetary Affairs, Ministry of Finance, 1994), chp. 1-3.

[34] The complete list of state-owned commercial banks was as follows: Chiao Tung Bank, the Farmers Bank of China, the Land Bank of Taiwan, the Cooperative Bank of Taiwan, the City Bank of Taipei, the City Bank of Kaohsiung, the Bank of Taiwan, the Central Trust of China, the Export-Import Bank of China, the First Commercial Bank, the Chang Hwa Commercial Bank, and the Hua Nan Commercial Bank. From: Kuo-shu Liang, 'The Banking System and Financial Reform in Taiwan' in *Industry of Free China* Vol. 78, No. 3 (September 1992). The island's biggest banks were the Bank of Taiwan, First Commercial, Chang Hwa and Hua Nan.

[35] The International Commercial Bank of China (ICBC) is the classic case here. ICBC was originally designated a state-owned bank until 1976 when in an effort to secure a foothold in the North American

onservative; collateral was almost always required to secure bank funding. The commercial tanks tended to favor state-owned enterprises over big private companies, and then big ompanies over small to medium sized enterprises.[36] Finally, with the formal banking system in ervile bondage, various black and grey markets for financial products became rife. We noted above that so-called curb or underground financial markets (*dixia shichang*) in Taiwan provided around 25% of the funds acquired by local enterprises. Other estimates suggest that at times, the curb market accounted for nearly 40% of acquired credit. Much of this underground activity included simple instruments such as employee deposits, credit rounds and post dated checks, but ome schemes were quite sophisticated. In the mid to late 1980s, for example, some 'underground investment companies' (*dixia touzi gongsi*) were starting to rival smaller banks as eposit takers.[37]

The amendment of the National Bank Law in 1989[38] saw the regulatory basis of many of these symptoms of repression eliminated. The most striking aspect of the reform initiative was the decision to permit the establishment of new private commercial banks. The business scope and powers of financial institutions were also extended and codified. Among other things, commercial banks were allowed to engage in the brokerage and dealing of short-term money market instruments, and the draconian prohibitions on the accumulation of bad debt were crapped. Interest rates on deposits and loans were allowed to float, and banks were granted the ight to establish additional branch offices throughout the island.[39] With these changes, the banking industry in Taiwan became far more efficient and user friendly. The most immediate effect was the introduction of more than a dozen new commercial banks. Pursuant to promulgation of the new regulations, there were 19 applications for new bank licenses, and all but four were accepted in 1991.[40] The introduction of these institutions brought a new level of competition to Taiwan's banking sector. Following an interest rate war through 1993-94, rate spreads on loans and deposits declined by around a third. The oligopolistic profits of the old banks fell to more reasonable levels, and a range of new bank products – such as credit cards, small business loans and auto teller machines – were introduced. With the formal banking ector increasingly sensitive to the needs of consumers, the informal financial sector soon encountered hard times; most of the underground investment companies either collapsed or vere absorbed by formal institutions. Finally, the 1989 reform agenda paved the way for the

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narket it was 'privatized' to comply with US banking laws. See: *International Commercial Bank of China, Annual Report 1995* (Taipei: ICBC, 1995).

[5] Ya-hwei Yang, 'Taiwan: Development and Structural Change of the Banking System' in Hugh T. Patrick and Yung Chul Park (eds.), *The Financial Development of Japan, Korea and Taiwan: Growth Repression and Liberalization* (New York: Oxford University Press, 1994), p. 294.

[7] Jane Kaufman Winn, 'Banking and Finance in Taiwan: The Prospects for Internationalization in the 990s' in *The International Lawyer* Vol. 25, No. 4 (Winter 1991), p. 916-920.

[8] *Zhonghua Minguo Yinhangfa* [Bank Law of the Republic of China] (Taipei: Bureau of Monetary Affairs, Ministry of Finance, 1989).

[9] Mu-Tsai Chen, 'Financial Liberalization and the Planning (sic.) for Developing a Regional Financial Center,' paper prepared for presentation at the 18th Joint Conference of USA-RoC and RoC-USA Economic Councils, Taipei (December 5-7 1994), section 2.

eventual privatization of the big state-owned commercial banks. Into the mid 1990s, the government moved to complete the sale of First, Hua Nan and Chang Hwa.[41]

2 Theoretical approaches to financial liberalization and Taiwan's reform experience

It is clear from the discussion above that both in terms of the legal framework governing Taiwanese finance and substantive economic outcomes, the KMT regime's reform efforts of the late 1980s were deep and enduring. Across the three key areas of RoC financial administration reviewed above, the difference in the situation before and after reform is undeniable – changes were real and purposeful, not merely an ephemeral reorganization of the status quo or an unintended consequence of some other policy process. The extent of financial reform pursued, if not striking by international standards, was a substantial deviation from Taiwan's historical pattern of financial policy (from a highly repressive regulatory framework to something much more liberal) and the flow of funds and structure of the local financial system reflected this.

And if these points are accepted – with apologies to those readers who would have taken such observations on faith rather than wade through the some of the drier details of the first section of this chapter – we are left with the questions raised earlier. Why did the KMT regime decide in the late 1980s to radically reform its regulatory framework for finance? Why, given what we know about the dirigiste proclivities of the ruling party – the KMT's 'will to control' if you like – did it choose to liberalize such a crucial area of economic administration? Luckily, questions such as these have been raised before about other episodes of financial reform in other countries; in theoretical and comparative terms at least, the questions are merely variations on a well-established theme. The academic literature dedicated to explaining *why* financial liberalization occurs can be divided into four main schools of theorizing. They include: the market-driven approach, statist analysis, pluralism, and the foreign pressures model. In the discussion that follows, I will detail the philosophical basis of the four theoretical schools, the predictions that the different theories yield, and the precision of each in the case of RoC financial reform. A number of quasi-theories or eclectic explanations that have been used to explain financial policy change (both in Taiwan and elsewhere) will *not* be considered.[42] While such explanations are often important for what they bring to light from an empirical point of view, they do not produce readily falsifiable statements.

The literature that falls within the gamut of the market-driven approach is expansive and has a variety of ideological homes. Nonetheless, the school is united in the proposition that the

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[40] A year later, a trust company was also granted a license bringing the total to 16.
[41] Willis Ke, 'High Hopes Amid Fiercer Competition' in *Financial and Investment Yearbook, RoC 1993* (Taipei: China Economic News Service, 1993); Willis Ke, 'Diversifying Services, Enhancing Automation' in *Financial and Investment Yearbook, RoC 1995* (Taipei: China Economic News Service, 1995); *Asia Yearbook, 1990* (Hong Kong: Far Eastern Economic Review, 1990), p. 232-233; and *Business Taiwan* [a publication of the China Economic News Service] (23-29 June 1997), p. 2-3.

international trend toward financial liberalization since the mid 1970s is largely explicable in terms of economic pressures to abandon bureaucratic controls on the allocation of savings and investment. According to mainstream neoclassical economists, technological development, the diminishing ability of established regulatory structures to cope with avoidance techniques, the expansion in the availability of financial instruments (financial innovation) and the increasing inefficiency of various kinds of financial repression have obliged governments everywhere to let the market decide where and how funds are allocated. In the economists' scenario, there is a certain inevitability about the switch from old to new patterns of financial regulation due to changed economic fundamentals. To prove their case, economists study the performance of various kinds of old-style financial administration, a favorite being capital account controls. They often find that not only do such controls fail to achieve established policy goals, but outcomes may indeed be the direct opposite of what was sought in the first place. Beyond this, a few economists are also interested in just *how* unsatisfactory policy outcomes move from the 'problem stage' to the introduction of new financial policy (i.e. liberalization). A small but important group of scholars have pointed to the key role of economic crises as a precursor to financial policy change.[43]

Although the jargon and analytical intent are quite different, the conclusions of mainstream economists are very close to that of a radical group of academic commentators: the regulation theorists. Regulation theory grew out of French Marxism during the late 1970s in response to the economic malaise of that decade. For regulationists, financial liberalization is simply one part of the broader realignment of capitalist states' superstructure with changed economic fundamentals. Regulationists argue that the supporting institutional structures of a particular stage of capitalist development (the legal, cultural and political frameworks Marxist scholars call the superstructure) simply 'wear out' with changes in the mode of production (the economic substructure in Marxist parlance). New regulatory forms are required to replace older frameworks of administration that have become progressively more unstable in the face of a systematic crisis of the economy. Regulationists tend to see the policy process of installing new institutional frameworks as inherently problematic, and usually characterized by much groping in the dark. The regulatory needs of a particular historical phase of development are rarely

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[42] See, for example, Karl Field's application of Peter Evans' 'embedded state' approach in Karl J. Fields, *Enterprise and the State in Korea and Taiwan* (Ithaca: Cornell University Press, 1995).

[43] Richard O'Brien, *Global Financial Integration: The End of Geography* (London: Pinter Publishers, 1992); Deepak Lal, 'The Political Economy of Economic Liberalization' in *The World Bank Economic Review* Vol. 1 (January 1987); Donald Mathieson and Liliana Rojas-Suarez, *Liberalization of the Capital Account: Experiences and Issues, IMF Occasional Paper #103* (Washington: International Monetary Fund, 1993); Steven B. Kamin, 'Devaluation, Exchange Controls, and Black Markets for Foreign Exchange in Developing Countries' in *International Finance Discussion Papers* [a publication of the board of governors of the US Federal Reserve, Washington DC], No. 334 (October 1988); and Allan Drazen and Vittorio Grilli, 'The Benefit of Crises for Economic Reforms' in *American Economic Review* Vol. 83, No. 3 (June 1993).

obvious and may require a great deal of experimentation before superstructure and substructure are matched – a coincidence that regulationists call an historical epoch.[44]

So given these theoretical tenets and observations, just what does the market driven approach actually predict and what does the Taiwan case of financial opening demonstrate? In essence, the market-driven approach predicts that financial reform will be preceded by unstable and unsustainable financial conditions. At first glance, this prediction appears to hold true for the Taiwan experience. The accounts of liberalization forwarded by many of Taiwan's academic economists, for example, point to Taiwan's burgeoning trade surpluses as a major catalyst for reform. One economist in Taiwan commented in an interview: 'Taiwan *had* to liberalize its financial system; it really had no choice in the matter. In the past, because we had an undeveloped economy, Taiwan had a lot of restrictions on things like forex trading, and bank ownership and management. In the 1980s this changed rapidly as Taiwan became wealthy and we started to register huge trade surpluses with the US and the rest of the world. This was unsustainable and we had to change.'[45] Another protagonist often emphasized is the so-called 10th Credit Cooperative scandal of 1985. This incident (which was basically a crisis of non-bank management and regulation – more in chapter 5) preempted a crisis of faith in Taiwan's domestic financial institutions, and called into question the motives and performance of the RoC monetary authorities. In quantifiable terms, it also lead to a loss of annual growth in the vicinity of 1% – almost one quarter of the growth figure for 1985.[46]

But while these events were significant in and of themselves (for reasons we will discuss later in the thesis), it must be remembered that in comparative terms Taiwan was never subject to the kind of market pressures that other countries have endured prior to their reform programs. The kind of hyperinflation experienced in Latin America[47] and the collapse of investment and government revenue experienced in Eastern Europe[48] did not coincide with Taiwan's reform transition. Taiwan's experience of 'market pressure' was mild by comparison. Indeed, at its most extreme, the impact of market pressures on Taiwan's financial system was *fragmented* and *isolated.* Some areas of financial administration, like the regulatory framework for foreign

44 Among the classic texts we can include: Michel Aglietta, *A Theory of Capitalist Regulation: The US Experience* (London: New Left Books, 1979); Alain Lipietz (trans. Ian Patterson), *The Enchanted World: Inflation, Credit and the World Crises* (London: Verso, 1985); and Robert Boyer (trans. by Craig Charney), *The Regulation School: A Critical Introduction* (New York: Columbia University, 1990).
45 Emphasis in original statement. Interview in Taipei, 1996.
46 *Far Eastern Economic Review* (12 September 1985), p. 93; and Fields, *Enterprises and the State in Korea and Taiwan*, fn. 42, chp. 5.
47 Chile in the late 1960s, early 1970s is probably the most obvious case here. See for example: Laura Hastings, 'Regulatory Revenge: The Politics of Free Market Financial Reforms in Chile' in Stephan Haggard, Chung H. Lee and Sylvia Maxfield (eds.), *The Politics of Finance in Developing Countries* (Ithaca: Cornell University Press 1993); and Jeffrey Frieden, *Debt, Development and Democracy: Modern Political Economy and Latin America, 1965-1985* (Princeton: Princeton University Press 1991), chp. 5.
48 See for example: Lipton and Sachs, 'Creating a Market Economy in Eastern Europe: The Case of Poland,' fn. 6; and Zbigniew Fallenbuchl, 'Poland: The Anatomy of Stagnation' in Joint Economic Committee, *Pressures for Reform in East European Economies, Volume* 2 (Washington: Congress of the United States, 1989).

exchange, were undoubtedly subject to considerable economic stress. Other areas, however, most notably securities administration, endured little if any pressure to speak of. And yet some commentators argue that the Securities Exchange Law amendments of 1988 were the most liberal, or at least extensive, of the policy reforms to be instituted in the late 1980s.[49] If we accept the central tenants of the market-driven literature, we would expect the reverse outcome – i.e. facing little market pressure on the established regulatory framework for securities, there would be little if any reform. A similar argument could be mounted for aspects of banking reform as well. The decision to pursue entry deregulation as part of the 1989 New Bank Law was only remotely connected to questions of institutional performance. While the 10th Credit Cooperative scandal certainly underlined the need for reform of banking practices and administrative oversight, the link with the liberalization of *bank entry* is tenuous to say the least.[50] In sum, the best the market-driven approach can do is provide a partial explanation of the Taiwan case of financial reform.

Another popular approach to the questions surrounding the global trend toward financial liberalization is 'statist analysis,' a body of literature that has clear intellectual antecedents in the work of political scientists such as Stephen Krasner, Theda Skocpol and Eric Nordlinger.[51] Writers who adopt a statist account of financial reform generally maintain that any particular course of liberalization is linked to the ascribed political will and priorities of state institutions – conceptions of governmental purpose which, in the final analysis, are divorced from sectarian social interests and personal interests (but which may include sectarian bureaucratic or executive interests). The 'state' in this scenario is usually defined after Weber as an administrative community claiming a monopoly of the legitimate use of force within a given territory.[52] In turn, state preferences are contingent on the institutional mechanisms or policy tools which give rise to differential capabilities both between and within states.[53] On a case-by-case basis, if you understand the goals of the state, as well as the broad capabilities of state institutions, you will go some way toward explaining why and how financial reform unfolds.

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[49] Brian Wallace Semkow, *Taiwan's Financial Markets and Institutions: The Legal and Financial Issues of Deregulation and Internationalization* (Westport: Quorum Books, 1992), chp. 11.

[50] Liu, 'Brave New World of Financial Reform in Taiwan, the Republic of China,' fn. 1, p. 195-210

[51] Among the classics, we can count: Theda Skocpol, *States and Social Revolutions* (New York: Cambridge University Press, 1979); Eric Nordlinger, *On the Autonomy of the Democratic State* (Cambridge: Harvard University Press, 1981); Stephen D. Krasner, ' Approaches to the State: Alternative Conceptions and Historical Dynamics' in *Comparative Politics* Vol. 16, No. 2 (January 1984). See also: Peter Evans, Dietrich Reuschemeyer and Theda Skocpol (eds.), *Bringing the State Back In* (New York: Cambridge University Press, 1985), various chapters. The early article by Nettle is also worth reviewing – arguably, this is where it all began: J.P. Nettle, 'The State as a Conceptual Variable' in *World Politics* Vol. 20, No. 4 (July 1968).

[52] Max Weber, 'Politics as a Vocation' in Max Weber (trans. H. Gerth and C.W. Mills), *Essays from Max Weber* (London: Routledge, 1948), p. 78.

[53] See: Stephen Krasner, *Defending the National Interest: Raw Materials Investment and US Foreign Policy* (Princeton: Princeton University Press, 1978) p. 5; and Eric Nordlinger, 'The Return to the State: Critiques' in *American Political Science Review* Vol. 82, No. 1 (1988) p. 882. For a more straight-forward saunter through the conceptual issues involved, see: Stephen Bell, 'Statist Analysis' in Andrew Parkin, John Summers, and Dennis Woodward (eds.), *Government, Politics, Power, and Policy in Australia* (Sydney: Longman Cheshire, 1994), p. 295-299.

Louis Pauly's seminal work *Opening Financial Markets* and Steven Vogel's more recent *Freer Markets, More Rules* are some of the more consistent and rigorous examples of the statist literature on financial reform. In *Opening Financial Markets*, the author suggests that while regulatory frameworks for finance '...have in recent years been converging in the direction of increasingly common [and liberal] regulatory standards.... the processes encouraging this evolution rest not on ineluctable economic forces but on political will.' Focusing on the evolving regulatory treatment of foreign banks in four countries (the US, Japan, Canada and Australia), Pauly seeks to demonstrate that a '...global village does not spontaneously spring up; it must be created. Politics within state structures remains the axis around which international finance revolves.'[54] Vogel takes Pauly's analysis one step further by problematizing the dependent variable (i.e. financial opening). Drawing on case studies of Japan and the UK, Vogel distinguishes financial deregulation, liberalization and reregulation as separate processes under the overall rubric of reform. He argues that states have combined these constituent processes in markedly different ways according to differences in the capacity and preferences of state actors. The final outcome, according to Vogel, is actually a three-way paradox: 'A movement aimed at reducing regulation has only increased it; a movement propelled by global forces has reinforced national differences; and a movement purported to push back the state has been led by the state itself.'[55]

The statist literature predicts that while a myriad of incentives for change (including deteriorating economic circumstances) may indeed be apparent, financial reform will only occur where it is seen as supportive of a state's goals, and where the arrangement of institutional powers allow for the pursuit of such reform. The Taiwan case of financial opening reveals some support for this prediction. Evidence garnered by Robert Wade demonstrates that financial liberalization in the late 1980s occurred in the context of a purposive redirection of industry policy by the RoC state. Wade shows that in the 1970s and early 1980s, the state's industry policy agenda (extant in key 'pilot agencies' such as the Industrial Development Bureau or *Gongyeju* of the Ministry of Economic Affairs) shifted from support of export oriented industrialization in general to promotion of high value-added areas of export production in particular. This shift in state goals preempted a shift in financial policy. While retention of a tight reign on the financial sector was once an important means of channeling scarce investment funds to export orientated manufacturing, in the transition to high-tech production, flexible financial products were required. Only mature financial markets can provide such products, and hence the state pursued financial reform in the late 1980s.[56]

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54 Louis W. Pauly, *Opening Financial Markets: Banking Politics on the Pacific Rim* (Ithaca: Cornell University Press, 1988), p. 2.

55 Steven K. Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries* (Ithaca: Cornell University Press, 1996), p. 5.

56 Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*, fn. 11, esp. chp. 4 and 6; and Wade, 'East Asian Financial Systems as a Challenge to Economics: Lessons from Taiwan,' fn. 3.

But what may have been true for the RoC state overall (or indeed, for key people within the state – more later in the thesis) was certainly not true for the state's constituent parts. Regardless of the redirection of industry policy Wade alludes to, most of the monetary authorities in the RoC state continued to pursue a vision of the public interest which involved a resolutely dirigiste relationship with the economy at large and the financial sector in particular. The key institutions responsible for financial policy – most importantly the Central Bank of China and the Ministry of Finance – were unquestionably committed to strong intervention in the financial sector. Much of this commitment was driven by an extreme fear of insolvency and an institutional mindset which emphasized avoidance of any kind of disruption to market order.[57] Although this position was more akin to a 'default setting' than a consciously derived objective, it was extremely entrenched and totally unconducive to the pursuit of radical policy change. Aside from these questions of intent, the institutional arrangement of financial policy administration in Taiwan was not supportive of the kind of cohesive and concentrated financial opening that occurred in the late 1980s. Responsibility for financial policy in Taiwan was spread out over a series of government agencies. Into the late 1980s, for example, bank supervision was the responsibility of *not only* the Central Bank *and* the Ministry of Finance, but also the Central Deposit Insurance Corporation, the Taiwan Cooperative Bank and one or two other agencies.[58] While under different circumstances this devolution of powers might have produced dynamism in the face of pressures for financial reform,[59] in Taiwan it killed ideas for policy change before they had a chance to take hold. The lack of functional jurisdiction among the RoC's monetary agencies meant that gridlock was the most typical response to new proposals. All in all, statist analysis gives us very little insight into the Taiwan case of financial liberalization.

The third school of theory that has been used to explain the origins of financial liberalization is pluralism. Writers who fall within this tradition tend to argue that reform is an outcome of the changing interests of private groups or coalitions. In an earlier era, regulated financial systems were in the perceived interest of domestically orientated business corporations and financial houses, and these groups lobbied governments everywhere for protection of local markets. In more recent years, however, corporations and financial concerns have developed global reach and have demanded – and received – more open regulatory arrangements for finance. The pluralist account of financial opening owes a large intellectual debt to political scientists such as Robert Dahl, Nelson Polsby, Aaron Wildavsky and Charles Lindblom.[60]

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[57] Interview in Taipei with Mr. Paul Hsu, Senior Partner, Lee and Li Attorneys at Law, 15 July 1999.

[58] This unsatisfactory situation is an ongoing feature of bank supervision in Taiwan. See: *CBC Annual Report, 1995* (Taipei: Central Bank of China, 1996), p. 91; and chapter 2, section one.

[59] Arguably, such dynamism is a distinguishing feature of fragmented administrative systems like those in the US and Australia and may have been responsible for the decisive processes of financial opening that occurred in both countries. I am indebted to Malcolm Cook for this point.

[60] See especially: Robert A. Dahl, *Who Governs? Democracy and Power in an American City* (New Haven: Yale University Press, 1961); Nelson W. Polsby, *Community Power and Political Theory* (New Haven: Yale University Press, 1963); Aaron Wildavsky, *The Politics of the Budgetary Process*, 2nd ed.

These writers claim that government decision makers have relatively little control over their policy agendas, and that power within any given society tends to be dispersed among a plurality of competing social groups. 'Power' for the pluralists is understood largely in behavioural terms as the ability of A to affect B's actions, regardless of B's resistance.[61] In essence, the pluralist account is a mid-range theoretical approach. Much of it assumes a political framework in which group association is relatively unconstrained, and government action is in some sense limited (i.e. constitutional) and open. These assumptions firmly ground the pluralist literature on financial reform in broader debates about the character of governance in democratic or democratizing polities.

Arguably the most theoretically parsimonious of the pluralist literature on financial reform is the work of the so-called Chicago school.[62] Chicago school theorists argue that the collective action dilemma first outlined by Mancur Olson in the 1960s[63] implies that government regulation of industrial sectors inevitably reflects the interests of those who are regulated (since such firms or producers are relatively few in number and have concentrated interests in regulatory outcomes). The access of industry representatives to the policy making process is usually assured through 'captured' regulatory agencies and vote-maximizing politicians. In this context, deregulation of finance emerges as a policy agenda when economic or technological changes give financial institutions and major consumers of capital a narrow self-interest in promoting the process. One of the more empirically impressive studies to make this case is Frances McCall Rosenbluth's *Financial Politics in Japan.* Focusing on the development of several aspects of Japanese financial regulation during the 1970s and 1980s (including Japanese forex regulation, banking, the bond market and the postal savings system) Rosenbluth argues: 'The Japanese financial sector comprises several well organized interest groups that have successfully employed their political resources to influence financial policy.... Rules governing private finance are changing because shifts in Japan's economic environment have rendered the initial regulatory structure no longer beneficial to these groups.'[64] The main players in Rosenbluth's account are Japanese banks, most importantly the 12 major 'city banks' which

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(Boston: Little & Brown, 1974); and Charles E. Lindblom, *The Intelligence of Democracy* (New York: Free Press, 1965).

61 Robert A. Dahl, 'The Concept of Power' in Roderick Bell, David M. Edwards and R. Harrison Wagner (eds.), *Political Power: A Reader in Theory and Research* (New York: Free Press, 1969). For the standard critique, see: Steven Lukes, *Power: A Radical View* (London: Macmillan, 1974).

62 See especially: James Wilson, 'The Politics of Regulation' in James Wilson (ed.), *The Politics of Regulation* (New York: Basic Books, 1980); George Stigler, 'The Theory of Economic Regulation' in *Bell Journal of Economics and Management Science* Vol. 2, No. 1 (1971); and Sam Peltzman, 'The Economic Theory of Regulation After a Decade of Deregulation' in *Brookings Papers on Economic Activity, Microeconomics* (1989).

63 Olson argued that within any particular political community there will be strong demand for a class of goods that are not diminished with the addition of *n* extra consumers (the most extreme examples are clean air and water, but others such as policing and national defense come close). These 'public goods' will be under-produced because self-interested individuals will avoid contributing to the provision of a good that they could consume irrespective of their personal contribution. Mancur Olson, *The Logic of Collective Action* (Cambridge: Harvard University Press, 1965).

dominate the local banking industry, and several large Japanese securities houses known ominously as the 'Big Four.'

So what does the pluralist account actually predict? A pluralist account suggests that where large private financial institutions and/or consumers of capital exhibit a subjective interest in financial opening, and where such agents have access to centers of financial policy making, financial reform will be pursued. Chen Shang-mao's impressive study of the evolution of RoC banking policy provides data suggesting that pluralist expectations were fulfilled in the decision to open up the banking sector in 1989. Chen attempts to demonstrate that in the period subsequent to the lifting of martial law in 1987, enterprise groupings (*guanxi qiye* or *qiye jituan*) were involved in a sophisticated campaign of political lobbying and executive infiltration that eventually saw the pattern of bank opening fashioned to suit their needs. Well-known industry conglomerates such as President Industries, Cathay Group, the Formosa Plastics companies and the Far Eastern Group were publicly and privately vocal in their desire or demand for entry into the banking sector. These preferences were communicated to the relevant authorities via a number of channels, one of the more important paths being informal networks between industry representatives and politicians in the Legislative Branch.[65]

The data on the *guanxi qiye* presented by Chen is certainly an important part of Taiwan's financial reform story (and we will revisit it later in the thesis), but whether it is indicative of a pluralist account of liberalization is debatable. The influence of Taiwanese business interests on economic policy was highly qualified. Through the late 1980s and beyond, many (indeed, most of the important) large-scale enterprises in Taiwan were state-owned and operated. As noted above, a vast array of activities were subject to direct state intervention – covering everything from agriculture to banking – leaving Taiwan with more than 150 public enterprises.[66] True, some of the *guanxi qiye* were impressive in their scope of operations – Hamilton et.al. comment that the top 100 *guanxi qiye* had interests in an average of four unassociated industries[67] – but by international standards they were small concerns. They possessed nothing like the market power of the *Keiretsu* in Japan or the *Chaebol* in South Korea, and were only considered significant in the Taiwan context due to the overwhelming domination of the local economy by small to medium sized enterprises.[68] Further, there is a conjectural problem associated with

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[64] Frances McCall Rosenbluth, *Financial Politics in Contemporary Japan* (Ithaca: Cornell University Press, 1989), p. 5.

[65] Shang-mao Chen, 'Taiwan Yinhang Zhengce de Zhengzhi Jingji Fenxi' [The Political Economy of Taiwan's Banking Policy], unpublished Masters manuscript, Department of Politics, National Cheng Chi University, Taipei (May 1998), see esp. chp. 4.

[66] Chi Schive, 'Experiences and Issues of Privatization in Taiwan' in *Industry of Free China* Vol.83, No.1 (January 1995); and Alice H. Amsden, 'Big Business and Urban Congestion in Taiwan: The Origins of Small Enterprise and Regionally Decentralized Industry (Respectively)' in *World Development* Vol. 19, No. 9 (1991).

[67] Gary G. Hamilton, Marco Orru and Nicole Woolsey Biggart, 'Enterprise Groups in East Asia: An Organizational Analysis' in *Shoken Keizai* No. 161 (September 1987).

[68] See: Susan Greenhalgh, 'Families and Networks in Taiwan's Economic Development' in Edwin Winckler and Susan Greenhalgh (eds.), *Contending Approaches to the Political Economy of Taiwan* (Armonk: M.E. Sharp 1988).

placing too much emphasis on the 'access to centers of finance policy making' of Taiwan's larger industry players. During the key years of financial opening – i.e. the last three years of the 1980s – the RoC was a democratizing country, not a democracy *per se*. At least until 1992, when major constitutional revisions were completed, the KMT regime continued to exercise extra-legal powers and privileges. In this context, even though Taiwan business interests were represented in key policy networks, there was no guarantee that anyone was prepared to listen to them. Well into the mid 1990s, the main administrative organs of financial policy – most notably the Central Bank of China and the Ministry of Finance – were kept well insulated from such influence.[69] In sum, a pluralist account of RoC financial reform is open to question on interpretation of evidence and conceptual grounds.

The final school of theory that seeks to explain the international trend toward financial reform is the foreign pressures model. Writers who propound a foreign pressures approach to financial liberalization contend that deregulation is ultimately attributable to the character of the international system of nation states. This system leads to two kinds of external pressure for liberalization: (1) direct political lobbying from states who perceive some kind of national disadvantage in other countries maintaining a repressed regulatory framework for finance, and (2) policy-competitive pressures generated by the ready availability of foreign alternatives to domestic financial services. In the former instance, the threat of retaliation in the face of a perceived lack of reciprocity in market access is usually cast as the mechanism of policy change. In the latter instance, the wholesale exodus of domestic financial institutions to offshore capital markets is often depicted as the conduit of reform. The foreign pressures model owes much to an economically sensitive strand of neo-realist international relations theory. This body of literature argues that a large part of what states do can be explained in terms of the unfettered competition among states for economic power, and the relative position of states within the international political economy. For these neo-realist writers, the international system is ultimately anarchic and hierarchically ordered; there is no overarching global authority and power is unevenly distributed among national actors.[70]

These various themes are comprehensively explored in Eric Helleiner's definitive work *States and the Reemergence of Global Finance*. Helleiner's book traces the development of the international financial architecture in the post-war years to the early 1990s. He presents three broad arguments. First, he contends that the old Bretton Woods financial order was retained until the early 1970s not because the restriction of finance was initially more efficacious or more economically rational, but because the US and other major powers were committed to it

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[69] See in particular: Yun-han Chu, 'The Realignment of Business-Government Relations and Regime Transition in Taiwan' in Andrew MacIntyre (ed.), *Business and Government in Industrializing Asia* (Ithaca: New York, 1994); and Tun-jen Cheng, 'Democratizing the Quasi-Leninist Regime in Taiwan' in *World Politics* Vol. 41, No. 4 (July 1989).

[70] See for example: Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987); Klaus E. Knorr, *Power and Wealth: The Political Economy of International*

for shared political and ideological reasons. Second, Helleiner argues that historically the advanced industrial states were key agents in promoting financial opening by: granting increased freedom to market participants in the 1960s (resulting in the emergence of the Eurodollar market), choosing not to prevent the collapse of Bretton Woods in the 1970s, and preventing major international financial crises at strategic junctures in the mid 1970s and 1980s. Pursuit of these actions was contingent on a number of state-interest factors, including the hegemonic strategies of the US and Great Britain. And finally, Helleiner claims that contrasts between the finance and trade policies pursued by different nations demonstrates that states can and have tolerated restrictive practices abroad (e.g. in trade policy) when it has been in their perceived interest to do so.[71]

Simply put, the foreign pressures model predicts that a country's experience of financial opening will be preceded by political or policy pressures from other nation states. There appears to be some support for this prediction in the Taiwan case of financial reform. It is folklore in Taiwan's expatriate business community that without the constant efforts of the United States and the American Institute in Taiwan, the financial reforms of the late 1980s would not have occurred, or at least would not have been as extensive as they were. In reply to a question about the likelihood of liberalization occurring in the absence of foreign pressure, one foreign banker replied: 'Hell would probably [have frozen] over first. Without the US waving Super 301 [the trade sanctions bill introduced by Congress in the late 1980s to assist the President in dealing with US trade partners deemed to be 'unfair traders'] in the face of Taiwanese officials there would have been no progress on the foreign exchange regime and insurance. Foreign lobbying is rarely 100% effective – I would never claim that – but it does count for a lot.'[72]

The impressions of Taiwan's expatriate businessmen are drastically overstated. While the foreign pressures model probably holds true for the lonely example of insurance (the exception that proves the rule?),[73] the model's predictions are found wanting in all other areas. The reality

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Power (London: Macmillan, 1973); and the all-time classic, Jacob Viner, 'Power versus Plenty' in *World Politics* Vol. 1, No. 1 (October 1948).

[71] Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca: Cornell University Press, 1994), esp. 'Introduction.' For a brief overview of Helleiner's central points, see: Eric Helleiner, 'From Bretton Woods to Global Finance: A World Turned Upside Down' in Richard Stubbs and Geoffrey Underhill (eds.), *Political Economy and the Changing Global Order* (Toronto: McClelland and Stewart, 1994).

[72] Interview with foreign banker in Taipei, 1996.

[73] The *complete* exclusion of US and other foreign insurers from the domestic insurance market prior to 1986 meant that it was a soft target during US-Taiwan trade negotiations. As a result of two rounds of talks, finance authorities in Taiwan eventually granted exclusive admission to American insurers at the rate of three new life and non-life companies per year, and permission to establish two branches of the same US company in Taiwan (i.e. head office and a subsidiary). These concessions were only a marginal win for US negotiators, but this was to be expected given that demands in this area were not made with the same gusto as on the trade front (see comments elsewhere in the paragraph). Once they had attained a minor presence in the local insurance market, the Americans were not prepared to debate the propriety and details of RoC insurance law. See: *Business Taiwan* [a publication of the China Economic News Service] (21-27 January 1991), p. 1. Includes extracts from a report compiled by the State Department on

is that foreign pressures for financial opening were *not* significant during Taiwan's late 1980s reform push. Regarding foreign political pressure, the regulatory structure of the financial system in Taiwan was never the direct target of foreign complaints. In the late 1980s, the US *did* lobby the KMT government fiercely on the issue of trade and the NT dollar exchange rate. Against the background of the Plaza-Louve currency realignment (1985-1987) and the passage of Super 301 (1986), the US went to some length to improve access for American products in the RoC market.[74] While we might have expected at least some concern with the character of Taiwan's financial sector during this period (especially the foreign exchange system), political pressure from the US simply *did not* include a focus on Taiwan's internal institutional arrangements. The state of the Taiwan's financial sector became the 'dog that didn't bark' in US-Taiwan economic relations.[75] Regarding foreign policy pressure, the RoC financial system was insufficiently linked to international markets to present the local finance authorities with any major threat of leakage. One commentator noted as late as 1995 that: '...Taiwan has 58 foreign bank branches, compared to 138 in Hong Kong and 124 in Singapore. To date, Taiwan has less than five foreign securities firms and no majority owned fund management companies. Hong Kong and Singapore have about 40 each. All domestic banks together have less than 80 branches abroad, while a single mainland [Chinese] bank boasts over 460 branches and offices in other countries.'[76] In this context, the specter of Taiwan's financial institutions running off to the Euromarkets was a remote possibility at best. All told, the foreign pressures model cannot provide a comprehensive explanation of the Taiwan case of financial opening.

3. Toward a new approach

The discussion above makes it abundantly clear that the established theories of financial liberalization can provide, at best, only partial explanations of RoC financial reform in the late 1980s. We have seen that while there is at least some supportive evidence for each of the four theories – a fact that indicates the previous section was not some hollow process of knocking down straw men – none of the four theories can fully explain the detail and scope of the Taiwan case. For a parsimonious and complete explanation, we really need a new theory of financial policy change.

Taiwan's bilateral trade surplus with the US. See also my Kui-ke Wu, 'Foreign Policies: Foreign Insurance Companies in Taiwan' in *China Post* (9 December 1996), p. 11.

[74] Vincent C. Siew 'Toward Liberalizing Trade and Improving Market Access' in *Economic Review* [bi-monthly magazine of the International Commercial Bank of China, Taipei, Republic of China] No.239 (September-October 1987).

[75] The reasons for this omission are not altogether clear. Perhaps the Americans had learnt from their bad experience in negotiating with the Japanese on similar matters. In that case, focusing on Japan's domestic institutional arrangements had rendered the American position diffuse and incoherent – with little concrete outcome. It is possible that with Taiwan, the US was trying to avoid making the same mistake twice. See: J. David Richardson, 'US Trade Policy in the 1980s: Turns – and Roads Not Taken' in Martin S. Feldstein (ed.), *Policy Change in the 1980s* (Chicago: University of Chicago Press, 1992).

[76] Christopher Ruhr, 'Opportunity Cost: Can Taipei Build a Regional Financial Center Without Internationalizing the NT Dollar?' in *Topics* [monthly magazine of the American Institute in Taiwan] (April 1995), p. 12.

But where to look for a new approach? As a starting point, we should revisit our dependent variable. On a general level, the changes in Taiwan's financial regulations and economic behavior that signified the reform moves of the late 1980s constitute a uniform shift from a very closed financial environment to quite an open one. We saw in section one of this chapter that in broad terms, change was comprehensive, enduring and above all real. However, if we examine more closely the three main waves of financial liberalization in Taiwan, we find that there is substantial variation in the *process* of reform in each case.[77] While the legal amendments occurred in a manner that suggests they were part of a singular process – it will be remembered that the three new laws were brought down successively in 1987, 1988 and 1989 – this was far from what actually occurred. There were strong differences in the amount of time and attention dedicated to shaping new policies for banking, securities and the forex system. Securities liberalization covered a total period of more than a decade, starting in 1980 when the KMT regime first experimented with margin financing on the Taiwan Stock Exchange. The road to February 1988 and the passage of the amended SEL was slow and methodical, and involved a series of contingent reform 'experiments' along the way. After the initial implementation of the amended SEL, consolidation of the new framework seemed to drag on forever: there were many loose ends and the project remained unfinished as late as 1992.[78]

The pattern of forex reform couldn't be more different. The entire process of foreign exchange liberalization occurred in the space of just three years or so, starting in early to mid 1986 with the decision to open up the current account. The introduction of the amended SAFE in July 1987 was the culmination of a breakneck process of preparation, and the final product of reform was a surprise to major stakeholders and the general public. The reform process was assiduously concluded in mid 1989 with the introduction of a series of new forex institutions – most notably a genuine float of the NT dollar. Finally, the banking reform episode has points of contrast with both securities and foreign exchange liberalization. The agenda for bank liberalization got off the ground in early to mid 1985 after the infamous 10th Credit Cooperative scandal, and underwent a period of slow development until the middle of 1988. It then experienced a stage of intensive policy work before the amended National Bank Law was finally passed in July 1989. Reform consolidation dragged on into the 1990s, but was more or

[77] With this slight shift in focus I am asking the reader to temporarily consider the question of *how* financial policy changed in Taiwan rather than *why*. I do this on the premise that questions regarding policy process both precede and preempt questions pertaining to the cause of policy transformation. That is to say, answering how a policy changes will put you on the right track to understanding the reason for such change. This view is broadly consistent with discussion on the theory of scientific inquiry in applied philosophy. See e.g.: Charles B. Cross, 'Explanation and the Theory of Questions' in *Erkenntnis* Vol. 34, No.2 (March 1991). I am grateful to Darshan Vigneswaran for walking me through the issues involved in distinguishing how versus why questions.

[78] The overviews presented here are summaries of part one of chapters 3, 4 and 5 of the thesis – the case study chapters. More in-depth information on the process (as opposed to outcome) of forex, securities and banking reform is included in these sections. Some preliminary detail can also be found in: Liu, 'Brave New World of Financial Reform in Taiwan, the Republic of China,' fn. 1. See also various chapters in: Mitchell A. Silk (ed.), *Taiwan Trade and Investment Law* (Hong Kong: Oxford University Press, 1994).

less complete with the granting of new bank licenses in late 1991 and the passage of follow-up legislation in early 1992.

TABLE 1.3 Process of Taiwan's 3 waves of financial reform, through the late 1980s

Policy Area	Time period	Pattern of Development
Securities	1980 to 1992 and beyond.	Pattern is slow and methodical, and involves contingent reform experiments; concludes with a number of loose ends.
Forex	Mid 1986 to mid 1989.	Pattern of policy development is frenetic but involves few loose ends; new policy framework surprises an unsuspecting public.
Banking	Mid 1985 to early 1992.	Originally pattern of development is slow until mid 1988 when the process gathers pace; largely concluded with new banks in 1991-92.

Sources: Various (see first sections of chapters 3 to 5 for details), but some introductory detail included in: Lawrence S. Liu, 'Brave New World of Financial Reform in Taiwan, the Republic of China - Three Waves of Internationalization and Liberalization and Beyond' in *Chinese Yearbook of International Law and Affairs* Vol. 8 (1988-89). See also various chapters in: Mitchell A. Silk (ed.), *Taiwan Trade and Investment Law* (Hong Kong: Oxford University Press, 1994).

This variance across the three waves of financial reform in Taiwan raises a series of intriguing comparative questions. Why did securities emerge as the first site of policy renewal, while the move to reform forex had to wait another six to seven years? Why was securities policy development so gradual and incremental, while development of the new foreign exchange law was rushed and decisive? Why did the process of banking reform start-off in a lackluster manner, but pick up pace later in the day? More generally, why does bank opening appear to be a 'cross' between the securities and forex reform episodes? Are the three waves of liberalization variations on a theme or totally separate events? And so on.

The variance between the three main waves of financial reform in Taiwan demands an explanation that is sophisticated and inclusive (yet still parsimonious). In the introduction of the thesis I proposed that in order to make any sense of financial opening in Taiwan during the late 1980s, we really need to study the leadership practices of technocrats within the KMT regime. Many readers, however, will see this proposition as the conceptual equivalent of looking for a needle in a haystack. Just what does 'leadership' mean? With the important exception of 'democracy,' the notion of leadership is one of the most hotly disputed concepts in the social sciences. It has been variously described as a physical trait, a psychological quality, a style of dominance, a feature of organizational dynamics, a process of role differentiation, a function of different kinds of political regimes, and my personal favorite, the opposite of 'follower.'[79] Even more concerning than the cacophony of definitions is the apparent lack of accumulative progress in any of the sub-fields engaged in studying the leadership phenomena. As one writer has lamented, 'the empirical regularities are neither robust nor compelling....'[80] Most case study material on leadership has almost nothing in common with other work in the same disciplinary area. Each new project is a discreet story with little relevance beyond its own descriptive boundaries.

Despite this conceptual imprecision and lack of continuity, most understandings of leadership can be placed into one of two categories: those conceptions which characterize leadership as some kind of utility maximizing practice within a given (institutional) framework, and those which associate it with a level of entrepreneurial endeavor that is not reducible to structural constraints. While the former understanding is generally believed to produce more readily testable propositions, the latter conception more readily encompasses those practices of idea generation, creative effort, teamwork and opportunism that we typically associate with leadership.[81] The problem for the latter term, of course, is using it to produce testable hypotheses that clearly delineate where agency is extant – how can we know where structural constraints end and entrepreneurial activities begin? This difficulty seems to be especially intractable for two interrelated reasons. First, the notion of leadership is typically associated with one or more outstanding or pre-eminent individuals rather than a team or group of people. This presupposes that agency can only be tied to single persons, when in fact it is quite conceivable that like-minded people could be jointly engaged in an entrepreneurial project. Second, in designating particular individuals as leaders, analysts tend to work backwards to see how these people came to be given the title in the first place. This kind of thinking is self-fulfilling and probably even tautological. Why not identify a group of 'could-be' leaders and see how they perform under conditions in which we might *expect* them to be entrepreneurial?

In the case of Taiwan financial liberalization, the group I would select as potential leaders are the senior policy technocrats of the RoC economic ministries. There is sound precedent in

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79 For a somewhat light-hearted review, see: Aaron Wildavsky, 'A Cultural Theory of Leadership' in Bryan D. Jones (ed.), *Leadership and Politics: New Perspectives in Political Science* (Lawrence, Kansas: University of Kansas Press, 1989).

80 Morris P. Fiorina and Kenneth A. Shepsle, 'Formal Theories of Leadership: Agents, Agenda Setters and Entrepreneurs' in Bryan D. Jones (ed.), *Leadership and Politics: New Perspectives in Political Science* (Lawrence, Kansas: University of Kansas Press, 1989), p. 17.

81 The former position has a natural constituency among strict adherents of rational choice theory. See, for example: Anthony Downs, *An Economic Theory of Democracy* (New York: Harper and Row, 1957); Charles Jones, 'An Essay on the Limits of Leadership in the House of Representatives' in *Journal of Politics* Vol. 30 (1968); Randall Calvert, 'Reputation and Legislative Leadership' in *Public Choice* Vol. 55 (1987); and Kenneth Shepsle and Brian Humes, 'Legislative Leadership: Organizational Entrepreneurs as Agents' paper presented at the Stanford Conference of Adaptive Institutions, Palo Alto (1984). The latter position has a mixed heritage. See e.g.: Jameson W. Doig and Erwin C. Hargrove (eds.), *Leadership and Innovation* (Baltimore: John Hopkins University Press, 1987); William H. Riker, *The Art of Political Manipulation* (New Haven: Yale University Press, 1986); Michael D. Cohen and James G. March, *Leadership and Ambiguity*, 2nd ed. (Boston: Harvard Business School Press, 1986); and Norman

the political economy literature on policy reform and the sociological literature on expertise for selecting this group.[82] Further, anecdotal evidence from interviews in Taiwan suggests that practically as well as formally, the buck probably stops with these people.[83] But what do we mean by a 'technocrat'? The most common conception of the policy technocrat is a state official who uses their claim to knowledge in some specialist area, or their ability to perform some specified function, to affirm their right to public office.[84] Beyond this minimalist definition, we can say that technocrats tend to place an emphasis on efficiency, meritocracy and the superiority of scientific rationality in policy making. This implies a rejection of the give and take of politics. Technocrats are likely to exhibit several shared values: prioritization of economic growth over other social ends, an acceptance of the need for political order, and a belief in the inevitability of social hierarchy. They are also likely to exhibit a similar intellectual pedigree: advanced university training, an in-depth understanding of (and probably direct experience of) policy-making in the advanced industrial countries of Europe and North America, and a fluency in internationalist discourses over nationalist ones.

So under what conditions would we expect technocrats to exhibit entrepreneurial patterns of behavior (i.e. 'leadership' on policy)? To answer this question, I propose that we take on board some of the findings of the literature on political parties and economic policy (hereafter 'the party/policy literature' – with apologies to exponents and the English language).[85] The party/policy literature has two major strands. The first of these includes the work of David Cameron, Douglas Hibbs, and R. Michael Alvarez et.al. Focusing primarily on a number of Western countries, these writers argue that economic policy choices are ultimately dependent on whether or not political parties of the Left or Right get into power. They present evidence confirming that Left-wing parties in government tend to increase public spending to reduce

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Frohlich, Joe A. Oppenheimer and Oran R. Young, *Political Leadership and Collective Goods* (Princeton: Princeton University Press, 1971).

[82] For the former, see in particular: John Williamson (ed.), *The Political Economy of Policy Reform* (Washington: Institute for International Economics, 1994); and Miguel A. Centeno and Patricio Silva (eds.), *The Politics of Expertise in Latin America* (London: Macmillan Press, 1998). For the latter, see: Jean Meynaud (trans. P. Barnes), *Technocracy* (London: Faber and Faber, 1968); and Frank Fischer, *Technocracy and the Politics of Expertise* (Newbury Park: Sage Publications, 1990). Much of this literature seems to owe an intellectual debt to earlier work by Putnam and others on elites. See esp.: Robert D. Putnam, *The Comparative Study of Political Elites* (Englewood Cliffs, N.J.: Prentice Hall, 1976), chp. 1.

[83] Popular opinion in Taiwan certainly gives the senior economic technocrats a large role to play in policy choice. Interviews in Taipei, 1996 and 1999.

[84] Definition and following comments from: Miguel A. Centeno and Particio Silva, 'The Politics of Expertise in Latin America: Introduction' in Miguel A. Centeno and Patricio Silva (eds.), *The Politics of Expertise in Latin America* (London: Macmillan Press, 1998), chp. 1.

[85] There are recent precedents for augmenting the work on leadership with insights from the party/policy literature. See esp.: Kaare Strom and Wolfgang C. Muller, 'Political Parties and Hard Choices' in Wolfgang C. Muller and Kaare Strom (eds.), *Policy, Office or Votes? How Political Parties in Western Europe Make Hard Decisions* (Cambridge: Cambridge University Press, 1999); and Kaare Strom, 'Party Leadership in Theory and in Norway' in Kay Lawson (ed.), *How Political Parties Work: Perspectives from Within* (Westport: Praeger, 1994).

unemployment, while Right-wing parties tend to restrict public spending to rein-in inflation.[86] Hans-Dieter Klingeman et.al. extend this analysis with the claim that the election platforms of parties on the Left and Right accurately predict post-election policy choices and economic outcomes.[87] The second strand of the party/policy literature includes some of the recent work on late development by writers such as Cheng Tun-jen, Stephan Haggard and Gregory Noble.[88] In general, these authors suggest that there is a strong casual relationship between market structure and development strategies in late developing countries and the organization and ideology of attendant ruling parties. Variations in market structure and development strategy will be largely explicable in terms of party political differences. So in Japan, for example, rule by the fragmented Liberal Democratic Party favored the ascendancy of a strong Weberian bureaucracy and large, vertically integrated industry groupings (i.e. the *Keiretsu*). In Taiwan, by contrast, the undisputed hegemony of the KMT and the ruling party's ideological disdain for big business favored the development of an economy largely composed of small to medium sized enterprises *(zhongxiao qiye)*.[89]

The real contribution of this literature is that it confirms that political parties matter in the economic policy choices governments make. But what specific conceptual implications does this work hold for our notion of the would-be entrepreneurial technocrat? A series of propositions follow from bringing together the concept of technocrat leadership with the findings of the party/policy literature. For our purposes, two of the most interesting ones concern *when* and *how* technocrats can be expected to engage in leadership on policy questions. First, we would expect that reformulation of, or threats to, a governing political party's social support base will generate opportunities for entrepreneurial technocrats to initiate policy change. Continuity in social support, by contrast, will restrict entrepreneurial activities. This broad proposition has antecedents in the earlier work of Lipset and others who argue that changes in

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86 See: David R. Cameron, 'The Expansion of the Public Economy: A Comparative Analysis' in *American Political Science Review* Vol. 72, No. 4 (December 1978); Douglas Hibbs Jr., 'Political Parties and Macroeconomic Policy' in *American Political Science Review* Vol. 71, No. 4 (December 1977); and R. Michael Alvarez, Geoffrey Garrett and Peter Lange, 'Government Partisanship, Labor Organization, and Macroeconomic Performance' in *American Political Science Review* Vol. 85, No. 2 (June 1991). Most recently, a number of scholars have been examining the impact of party politics on economic reform. See e.g.: Javier Corrales, 'Presidents, Ruling Parties and Party Rules' in *Comparative Politics* Vol. 32, No. 2 (January 2000).

87 Hans-Dieter Klingeman, Richard I. Hofferbert, Ian Budge, et al., *Parties, Policies and Democracy* (Boulder Col.: Westview Press, 1994).

88 See for example: Tun-jen Cheng, 'Political Regimes and Development Strategies: South Korea and Taiwan' in Gary Gereffi and Donald L. Wyman (eds.), *Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia* (Princeton, New Jersey: Princeton University Press, 1990); Stephan Haggard and Tun-jen Cheng, 'State and Foreign Capital in the East Asian NICs' in Frederic C. Deyo (ed.), *The Political Economy of the New Asian Industrialism* (Ithaca: Cornell University Press, 1987); Stephan Haggard and Sylvia Maxfield, 'The Political Economy of Financial Internationalization in the Developing World' in *International Organization* Vol. 50, No. 1 (Winter 1996); Stephan Haggard and Gregory W. Noble, 'Power Politics: Democracy and Electricity in Taiwan,' *Working Papers in Taiwan Studies* [published under the sponsorship of the APSA Conference Group on Taiwan Studies] No. 20 (1996); and Gregory W. Noble, *Collective Action in East Asia: How Ruling Parties Shape Industrial Policy* (Ithaca: Cornell University Press, 1998).

89 The nexus of Noble's argument in *Collective Action in East Asia*, fn. 88.

the ideology, strategy or organization of a political party are tied to shifts in the socio-economic environment.[90] Second, we would expect that failure of established policy to deliver outcomes in accord with a governing political party's strategic goals will also create opportunities for entrepreneurial technocrats to revise policy settings. Where such incongruence between party goals and policy outcomes is not apparent, however, we would anticipate limited entrepreneurial behavior. This narrower proposition, with its emphasis on perceived policy failure as a precursor of change, is reminiscent of the historical work of Hall and others on the rise and fall of Keynesian economics.[91] Together, these two simple propositions can be best understood as party political 'windows of opportunity' – political portholes through which entrepreneurial technocrats and their ideas for policy change can pass.[92] For want of better titles, we can refer to them respectively as the *socio-political window* and the *sectoral-strategy window*. For the purposes of this thesis, it will be assumed that these two windows represent the totality of opportunities for policy change facing technocrats. It will also be assumed that they are sufficiently rare as to open just *once* each in the short term, and are accumulative in their effect – i.e. the potential for technocrat leadership is greatest with both windows open.

So what predictions about any single case of financial reform can be derived from the various theoretical tenets and observations given above? Can we distill a unified theory of technocrat leadership that speaks both to the general phenomena of financial reform in Taiwan during the late 1980s, and to the alternative patterns of change within the various subsectors of RoC finance? In essence, the theoretical points outlined in the preceding paragraphs lead us to two contingent hypotheses. First, a theory of technocrat leadership predicts that in any given episode of financial opening we will be able to distinguish the presence of a core group of technocrats with an *ex ante* or independent plan for financial reform. Further, with the emergence of a window of opportunity within the governing political party, we will observe this

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[90] See for example: Seymour M. Lipset, *Political Man: The Social Bases of Politics* (London: Heinemann, 1960); and Seymour M. Lipset and Stein Rokkan (eds.), *Party Systems and Voter Alignments: Cross-National Perspectives* (New York: The Free Press, 1967), various chapters.

[91] Peter Hall, 'Policy Paradigms, Social Learning and the State: The Case of Economic Policymaking in Britain' in *Comparative Politics* Vol. 25, No. 3 (April 1993); G. John Ikenbury, 'Creating Yesterday's New World Order: Keynesian "New Thinking" and the Anglo-American Post-war Settlement' in Judith Goldstein and Robert Keohane (eds.), *Ideas and Foreign Policy: Beliefs, Institutions and Political Change* (Ithaca: Cornell University Press, 1993); and Peter Hall (ed.), *The Political Power of Economic Ideas: Keynesianism Across Nations* (Princeton: Princeton University Press, 1989), various chapters.

[92] The concept of the window of opportunity owes much to the work of Jeff Checkel on ideas and foreign policy change. See: Jeffrey T. Checkel, *Ideas and International Political Change: Soviet/Russian Behavior and the End of the Cold War* (New Haven: Yale University Press, 1997), esp. chp. 1. While I am strongly attracted to Checkel's appeal for the reintroduction of agency into questions of policy change, I part company with his focus on individual 'policy entrepreneurs.' At least in the Taiwan context, concentrating on individual 'leaders' as opposed to groups of activists leads to a dead end (I tried it...). This may be culturally related, although I find it difficult to believe that groups of technocrats do not behave in a concerted and entrepreneurial manner in a cross-section of other countries. In some of his later work, Checkle engages with broader debates on normative change and idea generation in international politics. See e.g.: Jeffrey T. Checkel, 'International Norms and Domestic Politics: Bridging the Rationalist-Constructivist Divide' in *European Journal of International Relations* Vol. 3, No. 4 (1997). After Checkel, in this thesis ideas are regarded as an attribute of particular agents rather than

group 'seize the day' and attempt to implement their plan for policy change. Second, behind a full cycle of financial reform we should be able to observe the successive emergence of both party political windows of opportunity (i.e. the socio-political window and sectoral-strategy window). Further, the temporal distribution of these two windows will influence the way technocrats pursue reform objectives: a wide distribution of windows will mean reform efforts are slow and incremental, while a narrow distribution will mean reform is fast and decisive.

A cursory review of the Taiwan reform experience suggests that our theory of technocrat leadership is probably on the right track.[93] The key to this conclusion – as implied in our examination of the *processes* of RoC financial reform above – lies in seeing the Taiwan case of liberalization as three distinct episodes conducted under the leadership of three factions or sub-groups within the technocracy. Although the senior policy technocrats of the RoC economic ministries were united in being more liberal in their outlook on policy matters than the final arbiter of state authority in Taiwan – i.e. the ruling KMT – there were divergences within the group which implied a differentiated role in financial opening. The slow process of securities reform owed much to the work of the so-called 'development technocrats,' especially technology guru Li Kwoh-ting.[94] This group was motivated by a belief that technological upgrading in Taiwan was strongly dependent on the development of more mature capital markets on the island. The development technocrats were able to launch their policy agenda in the early 1980s as the KMT came to see securities reform as an efficient means of co-opting support among the growing urban middle class (socio-political window opens). Securities reform peaked and then gradually consolidated after 1987 because the uncontrollable growth and emerging complexity of the local securities sector at that time was unacceptable to the ruling party (sectoral-strategy window opens). The long lead time between these two windows of opportunity meant that the development technocrats were obliged to make securities liberalization a gradual and methodical process.

The speedy pattern of forex reform was tied to the ideas and effort of the 'finance technocrats' – a small circle of officials loyal to finance expert and long-term policy practitioner Yu Kuo-hwa.[95] Yu and his cohort were driven by a firm conviction that the established forex system had outlived its original purpose. Early into 1986, the finance technocrats' reform agenda was assured the attention of the KMT as it became an effective means of shoring up

free-floating proposals waiting for adoption (a.k.a. the 'garbage can model'). We return to some of the thorny debates surrounding ideas and policy/political change in the conclusion.

[93] Information included below is a summary of data from sections two, three and four in chapters 3 to 5 of the thesis.

[94] The development technocrats were a latter-day version of the 'industrializing reformers' – a group that had been influential during the shift to export industrialization in the early 1960s. The leading light of this earlier group was K.Y. Yin, generally acknowledged as the architect of Taiwan's economic miracle. See: Stephan Haggard and Chien-kuo Pang, 'The Transition to Export-Led Growth in Taiwan' in Joel D. Aberbach, David Dollar and Kenneth L. Sokoloff (eds.), *The Role of the State in Taiwan's Development* (Armonk: M.E. Sharpe, 1994), p. 68-69.

party support among Taiwan's ailing small to medium sized enterprises (socio-political window opens). Within the space of a year, the technocrats' reform program received full backing from the ruling party because the established foreign exchange system was beginning to threaten the KMT's priorities for monetary policy (sectoral-strategy window opens). The negligible period of time between these two windows meant that the finance technocrats were able to make foreign exchange liberalization an expeditious course of action.

Finally, the middling process of bank liberalization was closely associated with the so-called 'young reformers,' an emergent group of younger technocrats that included the likes of Shirley Kuo and Wang Chien-shien.[96] The young reformers were motivated by two related factors: a belief that the local banking sector was grossly inefficient and uncompetitive, and a vision that Taiwan's financial system could one day compete as a regional or global financial center. From early 1985, the young reformers commenced their campaign for bank reform as the KMT reeled from the effects of the 10th Credit Cooperative scandal (sectoral-strategy window opens). They were given full reign to implement their plans after mid 1988 because the KMT saw bank reform as a way of sidetracking or diffusing the influence of the newly assertive *guanxi qiye* (socio-political window opens). The median period of time between these two windows meant that the young reformers crafted a style of bank reform that had features of both the securities and forex episodes (i.e. neither incremental nor rapid but somewhere in between these two extremes).

4. A brief note on evidence

Of course, the brief review of the evidence considered above raises just as many questions as it answers. What were the KMT's original goals for financial policy? As an authoritarian regime, what was the nature of the ruling party's social support base? What was the basic character of the relationship between the technocrats and the KMT? How can we actually 'observe' the motives for technocrat leadership? Is it possible to predict *ex ante* when and where the KMT windows of opportunity might open? And finally, to rephrase the question posed above, how can we know for sure where KMT political structures end and technocrat agency begins?

Before moving on to answer these questions and others, a few notes on methodology are called for. While it is not my intention herein to engage in a wide-ranging discussion on epistemological issues,[97] it is important to lay some preliminary ground rules for what will count

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[95] Indeed, the key role of Yu among the finance technocrats occasionally led to them being referred to as the Yu Faction or *Yu Xi*. See: Jun Wang, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [A Master of Finance: Yu Kuo-hwa's Career and Travels] (Taipei: Sunbright Publishing Company, 1999), p. 248.

[96] Also known as the NTU Gang (i.e. National Taiwan University) or *Taida Bang*. See: Cong-rong Li, 'Guojia yu Jinrong Ziben: Weiquan Shicong Zhuyi xia Guomindang Zhengquan Yinhang Zhengce de Xingcheng yu Zhuanxing' [The State and Financial Capital: KMT Bank Policy Form and Development under Authoritarian Rule] unpublished Masters manuscript, Department of Sociology, Tunghai University, Taiwan (1994), p. 108.

[97] With apologies to those interested in the philosophy of the social sciences. This is not to say that I am unconcerned with such matters. For want of more in-depth reading, my own approach to research has

as evidence in this thesis. Generally speaking, I will use three different kinds of evidence, the first two of which are relatively uncontroversial, and the last of which is a topic of hot debate in the social sciences. To begin with, for evidence on the character, ideas and subjective motives of the technocrats, I make strong use of secondary and primary-source biographical material. Focusing on biographical material is an established tradition in political science, and some of the most insightful analyses of leadership have been biographical case studies. While many of these works overemphasize the role of the individual in creating history, insofar as they bring the analyst close to the subject matter of decision-making, they make a crucial contribution to the discipline.[98] The measure of proof in this body of work generally echoes the rules of historiography: if an event, decision or proposal can be substantiated with reference to at least two sources, or can be shown to correlate with parallel historical facts, then it may be accepted as true. Some of the biographical material referred to in this thesis is fairly simple résumé-type information garnered from *Who's Who* reference texts, while elsewhere I make use of interview data and articles from the popular press (including local newspapers and magazines in Taiwan). Many of the technocrats who are the subject of this thesis have themselves written academic articles or books, and there are also a small number of biographies covering the life histories of several key technocrats.

Second, for evidence on the political economy of the KMT and the emergence of the windows of opportunity, I rely chiefly on a cross-section of materials garnered from mainstream political science and economics. This work is united in the priority given to broad social, economic or political forces over purposive action. The founding fathers of this systemic literature include the likes of Alfred Marshall (for economics), Robert Michels (for political science) and Joseph Schumpeter (for both disciplines).[99] In and of itself, much of this work does not inspire us with 'gripping tales of derring-do,' although I intend to demonstrate that it can and should be incorporated into our analysis in interesting ways. The standard of proof in this literature is simple enough: if variation in a structure, institution or tendency is readily observable and may be shown to be statistically or comparatively significant, then it may be admitted as evidence. Much of the social science material used in this thesis is acquired from the healthy stock of works on Taiwan's political and economic development (both English and Chinese). Where appropriate, I have supplemented this material with interview and media data.

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been strongly informed by some of the early historical sociology of writers like C. Wright Mills. See esp.: C. Wright Mills, *The Sociological Imagination* (New York: Oxford University Press, 1959).

[98] I'm thinking here of works such as: Robert A. Caro, *The Path to Power* (New York: Knopf, 1982), which focuses on the rise to office of Lyndon Johnson; and Edward C. Banfield, *Political Influence* (New York: Free Press, 1961), a study of the controversial Mayor of Chicago Richard Daley.

[99] The classic texts include: Alfred Marshall, *Principles of Economics: An Introductory Volume*, 8th ed. (London: Macmillan, 1927); Robert Michels, *Political Parties: A Sociological Study of the Oligarchial Tendencies of Modern Democracy* (Glencoe: Free Press, 1915); Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* (London: George Allen & Unwin, 1943); and Joseph A. Schumpeter (R. Aris trans.), *Economic Doctrine and Method: An Historical Sketch* (London: Allen & Unwin, 1954).

Further, the RoC government publishes a plethora of statistical reference texts; I have made full use of these publications.

And finally, for evidence on the association between technocrat leadership and the KMT windows of opportunity, I make use of a mix of 'soft' or speculative evidence that in part relies on counterfactual reasoning. Counterfactuals are 'what if' experiments conducted by researchers to assess the extent to which specified outcomes are fixed or unavoidable. They are usually performed in the face of conflicting or insufficient evidence, and can include a broad range of speculative tests: from the eminently plausible (Would the First World War have occurred if Archduke Ferdinand had returned safely from Sarajevo?) to those which verge on the incredible (Would the Cuban missile crisis have ended in a Soviet backdown if there had been no nuclear weapons?). In the last decade or so a resurgence of interest in counterfactuals has lead to increasing refinement in their use, and a gradual increase in their respectability among social scientists.[100] The measure of proof when using counterfactual evidence is tied to the extent to which it may be deemed reasonable or logical: if a counterfactual story is unambiguous, internally and analytically consistent, entails a minimal rewrite of history and allows for unanticipated or contingent outcomes, then we may accept its conclusions as accurate. In this thesis, the counterfactual evidence I will be using is largely negative and *ad hoc*. That is, to strengthen my interpretation of events, I will couch alternative counterfactual explanations with a view to dismissing them – of course, if they cannot be dismissed, then my interpretation must be flawed. They will be *ad hoc* in the sense that they will be derived on a case-by-case basis and not intentionally linked to any particular theoretical approach. The use of counterfactual evidence in this thesis will be sparse – an adjunct to the conventional data considered above. In this context, I see the application of counterfactual reasoning as an extension of factual reasoning; neither a replacement to be given analytical priority, nor an inferior version of the truth.

Conclusion

In the last years of the 1980s, the conduct of financial policy in Taiwan underwent a dramatic shift toward a more open, market oriented approach. In the years prior to the late 1980s, all three key areas of financial policy – i.e. the foreign exchange system, securities and banking – were subject to harsh repression. The forex system virtually precluded the export of capital, the securities sector was rendered a sideline to the investment decisions of most firms, and banking regulations enforced a strict government monopoly on financial intermediation. By the early to mid 1990s, however, the situation had changed radically. Foreign capital remittances were an

[100] Various points and comments from: James D. Fearon, 'Counterfactuals and Hypothesis Testing in Political Science' in *World Politics* Vol. 43, No. 2 (January 1991); Philip E. Tetlock and Aaron Belkin (eds.), *Counterfactual Thought Experiments in World Politics: Logical, Methodological and Psychological Perspectives* (Princeton: Princeton University Press, 1996); and Richard Ned Lebow, 'What's So Different About a Counterfactual?' paper prepared for the 2000 annual meeting of the American Political Science Association, Marriott Wardman Park (August-September, 2000).

option for all RoC citizens, there were more than a dozen new private banks operating alongside the old state-owned banks, and local securities markets were fast becoming a serious vehicle for raising corporate capital. This experience of financial opening implied a fundamental turnaround in the KMT regime's approach to financial policy – an approach that as late as 1986 seemed unshakable. Why, come 1987, did the government begin to change its mind? Why did the KMT decide that from 1987 on, the state would gradually begin to release its vice-like grip on one of the most important areas of economic management?

The literature on financial liberalization provides us with a number of plausible answers to these questions. The four major theoretical approaches within this body of work – the market-driven approach, statist analysis, pluralism, and the foreign pressures model – all provide at least some insight into the Taiwan case of financial opening. But despite the *prima facie* relevance of these models, it is apparent that none of them stand-up under close scrutiny. Further, a cursory review of the process of financial reform in Taiwan reveals that policy change in the late 1980s was infinitely more complex than the overall regulatory shift indicates – a fact that demands a fresh and theoretically sophisticated approach to solving the original puzzle. For a comprehensive and parsimonious explanation of events, I have proposed that we adopt an approach based on the notion of 'technocrat leadership.' The theory of technocrat leadership holds that financial reform is a function of the leadership practices and party political opportunities of policy technocrats. Toward the end of the chapter, we saw some preliminary evidence suggesting that technocrat leadership was an important factor in Taiwan's reform process. The task before us now is to conduct a rigorous review of the three major episodes of financial opening. Chapters 3, 4 and 5 of the thesis are dedicated to this undertaking.

Our immediate task, however, is somewhat more mundane. Before we can go on to talk about entrepreneurial projects and opportunities, we need to have more detail about the people and the party concerned. Just who were these mysterious policy technocrats mentioned above? And what of the political party to which they owed their allegiance, the KMT? As yet, we still know very little about these elements of reform. In the next chapter of the thesis we will take a first look at these elements with a view to laying the ground for analysis in subsequent chapters. We will also review the broad process of policy change under the KMT regime – a process that turns out to be a lot more complicated than the often-used title 'authoritarian' would seem to suggest.

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-Chapter 2-
The elements of reform

Introduction

In chapter 1 we saw how Taiwan's experience of financial liberalization in the late 1980s resulted in a radical transformation of the local financial system. The three main waves of legal amendment – that is, liberalization of the foreign exchange system, the securities sector and banking – heralded a plethora of new regulatory initiatives. Change was comprehensive, enduring and above all *real*. We also saw in chapter 1 that none of the established theories of financial liberalization forwarded in the contemporary political economy literature offer satisfactory explanations of the Taiwan reform experience. While the market-driven approach, statist analysis, pluralism and the foreign pressures model offer plausible accounts, they fall far short of a comprehensive explanation of the Taiwan case. Having made this argument, toward the end of chapter 1 I proposed that the focus of our research question should be slightly modified – from financial policy change *per se*, to the process of policy change – and a new theoretical approach adopted. As an alternative to the established theories of financial liberalization, I tentatively forwarded a new theory of technocrat leadership. This theory implies that Taiwan's reform effort was a function of the ideas and efforts of local economic technocrats, and the party political constraints and opportunities they faced within the ruling KMT.

But before we commence with the task of examining case studies, we are obliged to cover some descriptive material. This chapter is dedicated to providing an overview of the basic 'nuts and bolts' information that underpins analysis in subsequent chapters of the thesis. Most of the content is relatively uncontroversial, although I rely strongly on interview material for significant portions of it. Our principal task is to clearly detail the independent variables in the Taiwan reform story. The theory of technocrat leadership outlined in chapter 1 suggests two such variables: the economic technocrats of the RoC state as the primary agent[1] of change, and the KMT regime as a crucial intervening variable. While we have already referred to both entities extensively in the introduction and chapter 1 of the thesis, our knowledge of either is still limited. Just who were the economic technocrats that presided over Taiwan's various episodes of financial liberalization? How did this group link up to the ruling party's structure of command? What was the ideology, organization and composition of the KMT? What was the

[1] I use the terms 'agent' and 'agency' fairly loosely herein, nonetheless some brief definitional comments are probably warranted at the outset. By agents, I refer to social, political and economic actors (not exclusively individuals) that are distinguished by their capacity to interpret events, and the power to choose among behavioral options. By agency, I refer to the attribute of being able to interpret events and choose among options. See: Gil Friedman and Harvey Starr, ***Agency, Structure and International Politics: From Ontology to Empirical Inquiry*** (London: Routledge, 1997), chp. 1-2. While I appreciate the theoretical debates surrounding the use of these terms, the definitions used here are forwarded merely as a preliminary guide for discussion, and are not intended to contribute to any semantic disputes in the literature.

nature of the ruling party's brand of authoritarian rule, and how did it change over time? Finally, how did these two elements of the reform story relate to the old financial system, and what were their policy preferences (and were these preferences distinct)? In this chapter we will attempt to answer these background questions with a view to laying the groundwork for inquiry in later chapters. We begin the discussion with a brief review of the institutional context of financial policy in the RoC state. This material is presented merely in order to clarify *where* financial policy reform took place in Taiwan – i.e. the site or location of policy change. The substantive flesh on this organizational skeleton is presented in sections two and three of the chapter, respectively entitled 'The KMT regime' and 'The economic technocrats.'

1. The administrative machinery of financial policy in Taiwan

For most of the period of concern to us here (i.e. up to and just beyond the late 1980s), the RoC state was identifiable as the five-branch *(yuan)* and four tier structure of government administration stipulated by the RoC Constitution.[2] The five branches of administration combined features of Western and imperial Chinese practice, and included: the Presidential Office and Executive Yuan, the Legislative Yuan, the Judicial Yuan, the Control Yuan and the Examination Yuan. The four tiers of government included the central, provincial, county and special municipal (Taipei and Kaohsiung) governments. To the casual observer, all this may appear somewhat congested, a case of administrative overkill. Such an impression is quite appropriate: the RoC state on Taiwan was a system of government administration designed for a national polity the size of greater China. The events surrounding the KMT's retreat to Formosa in the late 1940s, however, saw it compressed and applied to the island of Taiwan and a few small remnants of nearby Fujian province (including the islands of Matsu and Kinmen off the mainland coast).[3] Generally speaking, policy development and implementation within this institutional structure was highly fragmented and often incoherent.[4] Effective policy performance was usually dependent on autocratic direction from the center – an attribute that prior to the democratization of Taiwanese politics, was partially supplied by martial law and the extra-constitutional edifice known as the 'Temporary Provisions.'[5]

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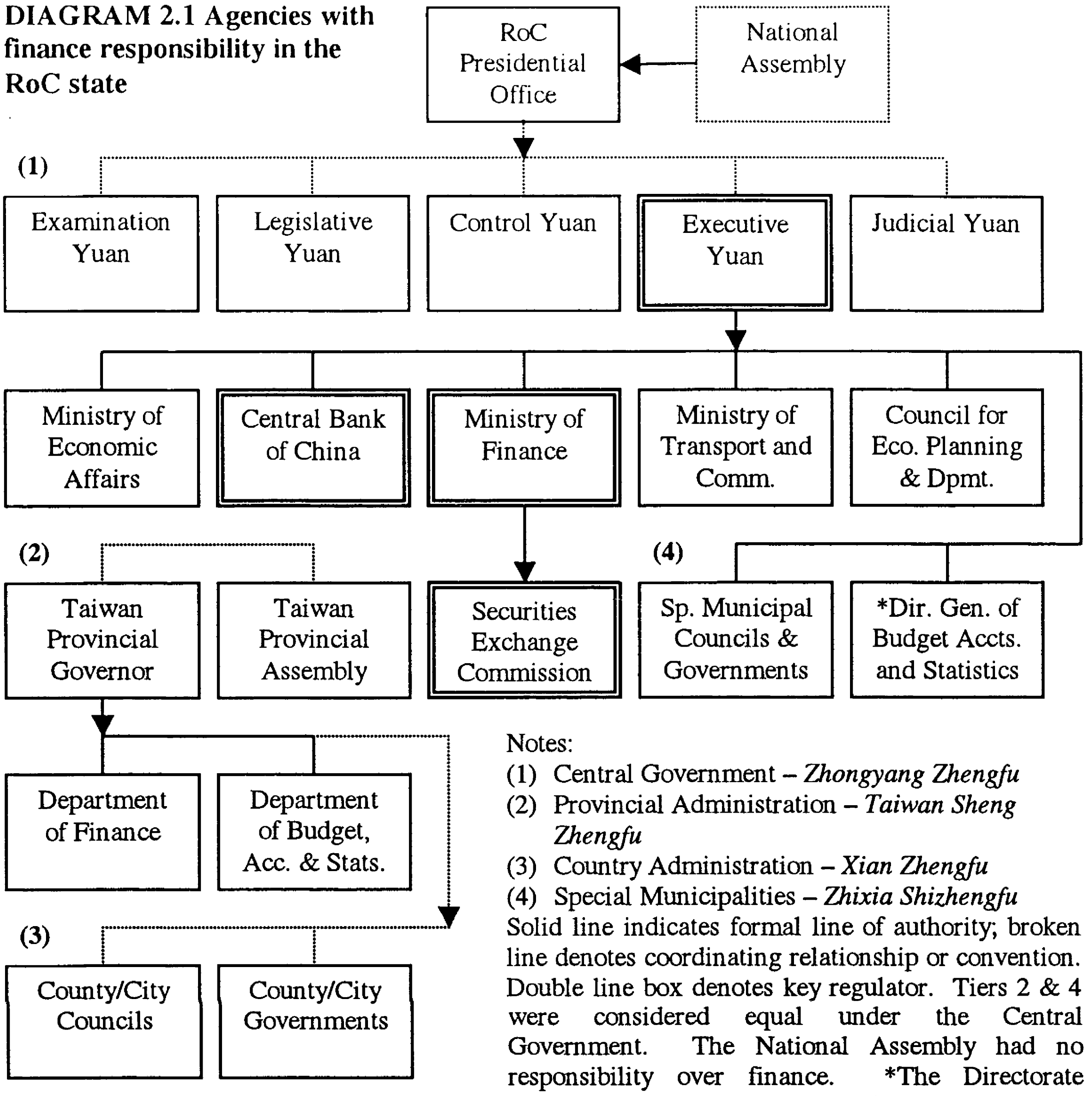
[2] Which remained essentially unchanged from its promulgation in 1947 till 1991 when the National Assembly passed the first round of major constitutional reforms. See: *Constitution of the Republic of China* (Taipei: Government Information Office, 1992).

[3] Hung-mao Tien, *The Great Transition: Political and Social Change in the Republic of China* (Stanford: Hoover Institution Press, 1989), chp. 5 & 6.

[4] Milan Tung-wen Sun, 'Public Administration in Taiwan: The State of the Art,' unpublished Ph.D. manuscript, Kent State University, Ohio (1992). See also: Gregory W. Noble, *Collective Action in East Asia: How Ruling Parties Shape Industry Policy* (Ithaca: Cornell University Press, 1998), p. 38-40.

[5] In full, the 'Temporary Provisions During the Period of National Crisis under the Communist Rebellion' (*Dongyuan Kanluan Shiqi*) – the legal edifice of executive privileges that the government assumed to monopolize power between 1949 and the early 1990s. Among these privileges was a suspension of regular elections. The Temporary Provisions are to be distinguished from martial law (*jieyan*), which was the basis of the intelligence operations performed by the dreaded Taiwan Garrison Command and curbs on due process in the courts. Martial law was lifted in mid 1987.

DIAGRAM 2.1 Agencies with finance responsibility in the RoC state



Notes:
(1) Central Government – *Zhongyang Zhengfu*
(2) Provincial Administration – *Taiwan Sheng Zhengfu*
(3) Country Administration – *Xian Zhengfu*
(4) Special Municipalities – *Zhixia Shizhengfu*

Solid line indicates formal line of authority; broken line denotes coordinating relationship or convention. Double line box denotes key regulator. Tiers 2 & 4 were considered equal under the Central Government. The National Assembly had no responsibility over finance. *The Directorate General of Budget, Accounts and Statistics reported to *both* the President and Executive Yuan.

Sources: *Taiwan Zhinan* [Directory of Taiwan] (Taipei: China News Publications, 1999); *Republic of China Yearbook, 1996* (Taipei: Government Information Office, 1996); Zhi-heng Yang, *Yusuan Zhengzhixue de Gouzhu* [Towards a Politics of Budgets] (Taipei: National Institute of Policy Research, 1991); and interviews in Taipei, 1996 and 1999.

Nowhere was this institutional imprecision more clearly demonstrated than with the administration of financial policy. Among those state authorities that were directly involved in the regulation of the RoC financial sector we can specify, as detailed in Diagram 2.1, nearly 20 distinct government agencies. A few examples will suffice to demonstrate the role of some of the more obscure ones: the Examination Yuan, through its powers governing civil service recruitment and promotion, was responsible for personnel appointments in state-owned banks; the Ministry of Transport and Communications, through its responsibility for the Directorate General of Posts, was accountable for the Postal Savings System (with some 15-20% of total demand deposits by the late 1980s); County Governments, with mandates to assist local industry and to supervise community financial institutions, often directly dictated the portfolio decisions of credit cooperatives and credit departments of industry associations; and the various organs of the Taiwan Provincial Government directly owned and managed some of the most profitable banking institutions on the island, including the 'Big 3' commercial banks (i.e. Chung-Hwa, Hua Nan and First). Add to these state institutions a series of quasi-public sector agencies such as the Central Deposit Insurance Corporation, the Taipei Dealer's Association and the Taiwan Stock Exchange, and the list of official regulators soon becomes very long and diffuse indeed. In this context, policy change was often 'messy' and implied a large amount of coordination work.[6]

At the center of this institutional milieu, however, we can point to four key regulatory authorities: the Executive Yuan, the Central Bank of China, the Ministry of Finance and the Securities Exchange Commission. Historically speaking, each of these institutions had a major role to play in the liberalization of Taiwanese finance during the late 1980s, although their respective interests in the process varied greatly. The Executive Yuan (*Xingzheng Yuan*) consisted of the Premier, the Vice-premier, ministers, and chairs of government commissions and councils. Convening regularly as the 'Executive Council' or Cabinet, the Executive Yuan officially exercised the ultimate powers of government in Taiwan: the power of supervision and authorization of subordinate agencies; the power to draft legislation on all matters of importance to the government, including financial policy; and the right of approval over laws and directives passed by the legislature.[7] In the heyday of authoritarian rule in Taiwan, however, the RoC President often assumed these various powers, and the Executive Yuan was restricted in what it could do independently. This observation should not be overstated. Policy areas requiring strong technocratic expertise – e.g. finance – were less subject to Presidential discretion than others. Regarding the Executive Yuan's broad approach to policy making (i.e. its institutional character or 'temperament'), the Executive Yuan tended to be no more than the sum of its parts. With some notable exceptions – i.e. the Council for Economic Planning and Development - the concentration of research and policy review functions within the ministries meant that the Executive Yuan's planning and development capabilities were actually quite limited.[8]

The Central Bank of China (*Zhongguo Zhongyang Yinhang*), originally established in Canton Province in 1928, was resurrected on Taiwan in the early 1960s. Its broad functions included: 'to promote financial stability; to guide sound banking operations; to maintain the stability of the internal and external value of the currency; and to foster economic development within the scope of the preceding objectives.'[9] The Bank's specific policy responsibilities

[6] Brian Wallace Semkow, *Taiwan's Financial Markets and Institutions: The Legal and Financial Issues of Deregulation and Internationalization* (Westport: Quorum Books, 1992), chp. 3; and Brian Wallace Semkow, *Taiwan's Capital Market Reform: The Financial and Legal Issues* (Oxford: Clarendon Press, 1994), p. 23-30; and various interviews in Taipei with government officials, 1996 & 1999.
[7] *Brief Introduction to the Republic of China* (Taipei: Government Information Office, 1993), chp. 3; and *Republic of China Yearbook, 1996* (Taipei: Government Information Office, 1996), p. 75-76.
[8] Interview in Taipei with Mr. Lin Huan, Coordination and Service Officer for APROC Window, Council for Economic Development and Planning, Executive Yuan, 26 March 1999.
[9] *Central Bank of China Act* (Taipei: Central Bank of China, 1979), art. 2, p. 1.

included the usual assortment of central bank duties: currency issue, banker to other banks, implementation of monetary policy, management of national reserves, oversight of financial institutions and administration of the foreign exchange system.[10] Strongly motivated by the belief that the KMT's loss of the Chinese Civil War was tied to its appalling record of financial mismanagement on the mainland (more below), the government conferred on the Central Bank a level of institutional autonomy unparalleled anywhere else in the RoC state system. While concerns were occasionally raised about the Bank's lack of legal independence,[11] in practice, external interests of a group-pluralistic or sectional nature were never allowed to compromise its integrity.[12] This autonomy was coupled with an obdurate conservatism on all financial policy matters. At various points in the 1970s and 1980s, the Central Bank's conservative outlook meant that it came into conflict with more progressive government agencies. Subterranean differences of opinion with the Ministry of Economic Affairs, the Council for Economic Planning and Development and the Ministry of Finance occasionally surfaced to remind observers just how seriously the Central Bank was about its self-proclaimed role as an 'insurer' of the Taiwan economy.[13]

If the Central Bank represented the conservative end of opinion on financial policy within the RoC state, the Securities Exchange Commission (*Zhengquan Guanli Weiyuanhui*) was the radical alternative. The Securities Commission was originally established in 1960 as an autonomous department of the Ministry of Economic Affairs (and subsequently moved to the Ministry of Finance in 1982). Formally speaking, the Securities Commission counted among its administrative responsibilities: regulation of the local stock exchange; administration of the offering, issuance and trading of securities; supervision of all financial institutions participating in Taiwan's securities markets; oversight of listed firms; co-ordination of securities financing activities; and drafting of securities regulations.[14] Despite the impressive list of formal powers, the Securities Commission was a relatively weak organization when compared to the other key financial regulators. Its existence reflected a desire for administrative specialization by the

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[10] Details can be found in any CBC annual report. See for example: *CBC Annual Report, 1995* (Taipei: Central Bank of China, 1995), chp. 12-14.

[11] Notable here are economist S. C. Tsiang's concerns regarding the transfer of the CBC's formal line of authority from the President to the Executive Yuan in 1979. See: S.C. Tsiang, 'Monetary Policy of Taiwan' in Kwoh-Ting Li and Tzong-Shain Yu (eds.), *Experiences and Lessons of Economic Development in Taiwan* (Taipei: Institute of Economics, Academia Sinica, 1982).

[12] That is, the Central Bank maintained a very high level of what Sylvia Maxfield has called 'defacto authority.' Sylvia Maxfield, 'Financial Incentives and Central Bank Authority in Industrializing Nations' in *World Politics*, Vol. 46, No. 4 (July 1994).

[13] As one academic in Taipei remarked in an interview: 'The CBC saw itself as a national insurer of sorts which not only had economic priorities to take care of, but political goals to attend to as well. This placed the Bank in a unique position when compared to other central banks from either developed or developing countries.' Interview in Taipei with Dr Ray B. Dawn, Director of Financial Research Division, Taiwan Institute of Economic Research, 19 June 1996.

[14] Available from any SEC annual report. See for example: *SEC Annual Report, 1995* (Taipei: Securities Exchange Commission, Ministry of Finance, 1996), p. 8-9.

government rather than a conscious attempt to maintain a distinct financial authority.[15] While less influential than the other regulators, the Securities Commission was seen as one of the most progressive government agencies responsible for finance. At its inauguration in the early 1960s, it was charged with developing the securities sector in Taiwan, a task it pursued with a 'pilot agency' mentality and an organizational culture that stressed individual performance over bureaucratic conformity.[16] As a result, by the early 1980s the Securities Commission and attendant agencies were often the organizations of career choice for aspiring finance personnel returning from a period of work and study abroad (an issue we return to below).[17]

And finally, the Ministry of Finance (*Caizhengbu*). The Ministry of Finance had a long heritage that dated back to the early years of the establishment of the RoC on the mainland. Soon after the KMT retreated to Taiwan in the late 1940s, the Ministry of Finance was resurrected to look after the central government's taxation and expenditure requirements, customs and tariff administration, and several matters related to the planning and administration of financial policy and oversight of financial institutions. To perform this wide spread of tasks, the Finance Ministry had four relatively independent departments (Monetary Affairs, Taxation, National Treasury and Customs) that individually and together commanded less status and authority in the administration of financial matters than the Central Bank. The autonomous structure of these various departments tended to leave the overall Ministry with a schizophrenic quality, and created strong incentives for interdepartmental competition (a.k.a. bureaucratic politics).[18] This organizational disposition was strongly reflected in the way the Finance Ministry handled policy implementation. To a significant extent, slow progress on the reduction of import barriers in the mid 1980s reflected the Ministry's inability to reconcile the general policy of tariff liberalization with the specific and divided claims of the Customs and Taxation Departments.[19]

As suggested above, the financial policy process within and between these various institutions was fragmented and often incoherent. The institutional imprecision of the RoC state and the vagaries of authoritarian rule on Taiwan make it difficult to comment with any certainty on the precise path of financial policy change. With this in mind, I rely on specific material in

[15] Indicative of the SEC's organizational weakness was the composition of its committee of directors: in addition to four or five positions drawn from within the SEC, it also maintained five ex-officio positions for representatives from the Ministry of Finance, Central Bank, Ministry of Economic Affairs, Ministry of Justice and Executive Yuan. *SEC Annual Report, 1994* (Taipei: Securities Exchange Commission, Ministry of Finance, 1995), p. 7

[16] Interview in Taipei with former Chair of the Securities Exchange Commission, Dr Gordon Chen, 20 July 1999.

[17] Some of these 'returnees' now hold many of the most important positions in Taiwan's post-reform financial industry. See my newspaper interview with Benny Hu: Kui-ke Wu, 'New Directions, Here and Abroad' in *China Post* (11 November 1996), p. 11.

[18] For details on the structure and operation of the MoF, see: *Government Finance of the Republic of China* (Taipei: Ministry of Finance, 1990), p. 1-3. In 1991, the number of departments within the Finance Ministry was increased from four to five with the addition of the Department of Insurance: *Insurance Annual Report of the Republic of China, 1995* (Taipei: Department of Insurance, Ministry of Finance, 1995), p. 31.

the case study chapters to build up a map of the specific patterns involved. This being said, the financial policy process exhibited *some* measure of formal regularity that can be described up front. In the first instance, we know that initiatives for policy change emerged from the relevant financial regulators and were subsequently tendered to the Executive Yuan for approval (typically in the form of a proposal for a statute amendment, a budget change or a jurisdictional dispute).[20] Decision-making within the Executive Yuan was always consensus oriented; policy debates or controversy were deliberately avoided and therefore very rare. If a finance policy issue before the Executive Yuan generated internal disagreement, then Cabinet would typically submit it to an executive council (e.g. the Council for Economic Planning and Development) for further consideration. In due course, the designated council would convene an *ad hoc* committee including all the relevant bureaucratic players (and occasionally those from outside government) to discuss the matter and come up with a compromise decision. The *ad hoc* committee was obliged to continue deliberations until a resolution acceptable to all participants was reached – the Executive Yuan would not accept a split decision. Sometimes it took months or years to arrive at a final resolution.[21] Once the committee reached a consensus, however, the decision was submitted to the Executive Yuan for immediate authorization. At this stage in the process, the Executive Yuan's role was largely that of a rubber stamp.

Once Executive Yuan authorization was achieved, and an amendment to RoC financial law deemed necessary, draft legislation was submitted to the Legislative Yuan for review. After the first of three readings, the proposed law was often given over to an internal legislative committee that included all those lawmakers with a declared interest. Despite the limits implied by authoritarian rule on Taiwan, these meetings often degenerated into a political free-for-all. Legislative committees were permitted to discuss a wide range of matters, and frequently lawmakers raised concerns only distantly related to the draft law at hand. Sometimes the lawmakers behaved in this manner in order to extract personal benefit out of the proposed policy change; other times committee debate was used as a means to draw attention to some external issue. However, as the Legislative Yuan lacked its own internal research and administrative support staff, policy committee meetings were often expedited with the assistance of appointees from the Executive Yuan. This gave officials from the relevant regulatory agencies a chance to have direct input into the legislative process: in exchange for

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19 Suggested in an interview with bank officers from Taishin International Bank, Taipei, 1 October 1996.

20 Most of the descriptive comment below is based on interview material. I am particularly indebted to an interview in Taipei with Mr Lin Huan, Coordination and Service Office for the APROC program, Council for Economic Development and Planning, Executive Yuan, 26 March 1999.

21 The political and strategic use of a decision-making process which relies on consensus is the matter of considerable debate in the literature. Most writers, however, point to the role of consensus as a conservative force in decision-making, and the manipulation of consensus to discredit dissent. There were certainly aspects of both motivations in the Taiwan policy process. We return to this issue at various points later in the study. For more on the theory and practice of consensus decision-making, see: Serge Moscovici and Willem Doise (W.D. Halls trans.), *Conflict and Consensus: A General Theory of Collective Decisions* (London: Sage Publications, 1994); and Seymour M. Lipset, *Consensus and Conflict: Essays in Political Sociology* (New Brunswick: Transaction Books, 1985).

their material support, they were permitted speaking rights and the right of reply.[22] Committee deliberations were concluded once a consensus decision (to support or reject the proposed legislation) was reached. Like the *ad hoc* committees of the Executive Yuan, sometimes this took an inordinate amount of time to achieve. But once again, with a consensus reached, the legislative committee's decision was regarded as final. As soon as the legislation was returned to the floor of the Legislative Yuan it would rarely evoke further debate. Second and third readings of the draft legislation usually followed in quick succession resulting in the statute's ultimate passage into law.

From here, a new financial policy had only two more hurdles to navigate. Once the Executive Yuan received the new law it would consider any changes included by the Legislative Yuan. Under strongman rule, such changes were typically minimal and more than likely negative (i.e. involving the removal of statute clauses rather than additions). If the Executive Yuan was unsatisfied with the new law, it might be sent back to the legislature (up to three times), or left in abeyance (potentially forever). If on the other hand, the Executive Yuan was satisfied that the original intent and purpose of the law was intact, it could immediately pass the document on to the President. At this point in the process, the President's duty was largely ceremonial. Within a short period of receiving the new law, the President would sign-off on the document and declare it effective (an act known as 'promulgation' – *gongbu* or *fabu*). Promulgation opened the way for the new financial policy to be implemented. The agency originally responsible for initiating the policy change then proceeded to put the new law into effect.

2. The Kuomintang regime

While the comments above indicate where and to some degree how financial policy was devised and implemented on Taiwan, the question of why is obviously left wanting. To put political flesh on the bare bones of the regulatory framework described above, we have to look further afield. And in the first instance, that means examining the role and nature of the KMT regime.[23]

[22] With the transition to democracy in Taiwan, the *ad hoc* legislative committees have been formalized as the Party Conciliation Committee (*Zhengdang Xieshang Weiyuanhui*). This standing committee of the Legislative Yuan includes representatives from each of the major political parties, with the committee chair chosen on a rotating basis. Most of the points raised here for the informal legislative committees are also valid for the new standing committee, although the salience of interest-based politics in the new forum, predictably enough, has increased. There is little secondary literature on Taiwan's Legislative Yuan committees, either contemporary or historical, in English or Chinese. For one lone example which at least broaches the subject, see: Lang Gao, 'Congtong, Xingzheng Yuan, Lifa Yuan zhi Guanxi Wenti' [Problems in Relations Between the President, the Executive Yuan and the Legislative Yuan], paper presented at an academic seminar, National Chengchi University, Taipei (November 1991).

[23] I use the term 'regime' when describing the KMT to indicate I am referring to something greater than both the Nationalist political party and the RoC state. It is also a reference to the style of power wielded by the KMT. The terminology is in line with the work on democratic transition of writers such as Fishman. See for example: Robert Fishman, 'Rethinking State and Regime: Southern Europe's Transition to Democracy' in *World Politics* Vol. 42, No. 3 (April 1990).

The KMT regime that fled to Taiwan at the end of the Chinese Civil War was based on the political party first established by Dr Sun Yat-sen (*Sun Zhong-shan*) in the early 1920s. To the degree that the KMT prioritized control over mobilization and emphasized pragmatism over ideological correctness, the ruling party was highly authoritarian at times but not fundamentally totalitarian.[24] The KMT claimed a tutelage role in the implementation of Dr Sun's Three Principles of the People (*Sanmin Zhuyi* - nationalism, democracy and people's livelihood). The Three Principles were an eclectic mix of political ideas, cobbled together in response to the sad events that befell China during the 19th Century (the so-called '100 years of shame' – *bainian chiru*). At a rudimentary level, they were simply a call for decency and minimum standards: a free and united China, constitutional government and the rule of law, and provision for the necessities of life. However, a more sophisticated appraisal of the Three Principles reveals their wide application and ambiguity. Nationalism could be used to rally opposition against the Chinese communists just as much as the Japanese; democracy could be portrayed as simply a set of values or aspirations rather than a tangible system of government; and people's livelihood could be used to justify everything from a command economy to free market capitalism. The Three Principles were not quite all things to all people, but very nearly. After the retreat to Taiwan in the late 1940s, the KMT leadership headed by Generalissimo Chiang Kai-shek (*Jiang Jie-shi*) choose to interpret Dr Sun's ideas in a pro-Western light; however there was nothing inevitable about this turn.[25]

The KMT's experience of government on mainland China was a stern lesson in what not to do when in power, and had a strong impact on the ruling party's understanding of its mission once ensconced on Taiwan. From the 1920s to 1945 the party fought a secession of conflicts with the warlords of northern China, the communists and then the Japanese. Soon after the end of the Second World War, conflict with the communists broke-out anew, occasioning a general loss of confidence in the KMT's ability to rule and the retreat to Taiwan Province.[26] For many in the Nationalist Party, including Chiang Kai-shek himself, the Communist victory was due to the party's own 'tragic failure'[27] to govern effectively. Nowhere was this more apparent than in the area of economic management. Due to proliferate government spending, administrative ineptitude, corruption and factional infighting, the KMT presided over some of the worst inflation the world has ever seen. Over the second half of the 1940s, the Chinese National

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[24] A distinction based on Linz's classic work. See: Juan Linz, 'Totalitarian and Authoritarian Regimes' in Fred Greenstein and Nelson Polsby (eds.), *Handbook of Political Science, Vol.3, Macropolitical Theory* (Reading: Addison-Wesley, 1975).

[25] Various points from: Sun Yat-sen, *Sanmin Zhuyi* [The Three Principles of the People] (Chungking: Ministry of Information of the RoC, 1943); Marie-Claire Bergere [trans. Janet Lloyd], *Sun Yat-sen* (Stanford: Stanford University Press, 1998); Xiao-buo Wang, *Sun Zhong-shan Xuanji* [Sections of the Work of Sun Yat-sen] (Taipei: Pamierh Book Company, 1984); and Anthony James Gregor, Maria Hsia Chang and Andrew B. Zimmerman, *Ideology and Development: Sun Yat-sen and the Economic History of Taiwan* (Berkeley: UCLA Institute of East Asian Studies, 1981).

[26] From: Gong-an Wang, *Guogong Liangdang Guanxi Shi* [A History of Kuomintang-Communist Party Relations] (Wuhan: Wuhan Chubanshe, 1987).

Currency (CNC - *Fabi*) depreciated from around CNC2,000:US$1 in 1946 to over CNC23 million:US$1 just three years later. Towards the end of this debacle, more than half of government expenditure was funded with the printing press; in some provinces the KMT was forced to resort to the death penalty to prevent currency substitution and hoarding.[28] After the flight to Taiwan and the party reforms of the early 1950s (more below), the KMT leadership started to listen to its cohort of economic advisors and gradually elevated the cause of developing Taiwan to a position above that of military and political objectives (or at least commensurate with these goals). In the shadow of the 'unfinished war' with the mainland communists and under the relative safety of the US security umbrella,[29] economic policy on Taiwan became an end itself. This reordering of priorities was eventually solidified in the adoption of externally oriented industrialization – a policy strategy that set the RoC on the path of rapid growth and, into the 1980s, gave rise to Taiwan's wide acclaim as a miracle economy.[30]

The organizational structure of the ruling party as it developed on Taiwan was rigidly hierarchical, but also composed of multiple and occasionally competing interests.[31] Power within the KMT was focused in the Chairman (*Zhuxi*) and the Central Standing Committee (*Zhongchenghui*), with the latter firmly subordinate to the former.[32] In the early 1950s, under the guise of reform, Chiang Kai-shek purged the party of any internal opposition and sought to entrench a system of corporatist decision-making. Thereafter the Chair of the KMT stood at the apex of a quasi-Leninist organization (see Diagram 2.2 for a visual representation of Leninist organizational principles), with decision-making as well as appointment and promotion subject

[27] To use Chiang's own words; see: Milton J.T. Shieh, *The Kuomintang: Selected Historical Documents, 1894-1969* (St. John's University Press, 1970), p. 213.

[28] Kia-ngau Chang, *The Inflationary Spiral: The Experience in China, 1939-1950* (New York: John Wiley and Sons, 1958); and Shun-hsin Chou, *The Chinese Inflation, 1937-1949* (New York: Columbia University Press, 1963).

[29] See esp.: Ralph N. Clough, *Island China* (Cambridge Mass.: Harvard University Press, 1978); Neil H. Jacoby, *US Aid to Taiwan: A Study of Foreign Aid, Self Help and Development* (New York : F.A. Praeger, 1967); and Chiao-chiao Hsieh, *Strategy for Survival: The Foreign Policy and External Relations of the RoC on Taiwan* (London: Sherwood, 1985).

[30] Tun-jen Cheng, 'Political Regimes and Development Strategies: South Korea and Taiwan' in Gary Gereffi and Donald L. Wyman (eds.), *Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia* (Princeton, New Jersey: Princeton University Press, 1990); and Yong-jing Jiang, *Bainian Lao Tian: Guomindang Cansang Shi* [One Hundred Year Store: The Kuomintang's Turbulent History] (Taipei: Chuan Chi Wenhsueh Publishers, 1993).

[31] As this statement suggests, the structural organization and functional composition of the KMT were somewhat contradictory. To my knowledge, only one writer has attempted to show how party structure and composition were integrated. See: Edwin A. Winckler, 'Institutionalization and Participation on Taiwan: From Hard to Soft Authoritarianism?' in *China Quarterly* No. 99 (September 1984). The current study builds on Winckler's central insight that the formal hierarchy of the KMT encompassed far more intra-party dynamism (both lateral as well as vertical) than is usually acknowledged.

[32] Although *in principle*, the Kuomintang Chair was *not* supreme within the ruling party, the sum-total of the Chair's special privileges over the National Representative Conference, the Party Central Committee, and the Central Standing Committee gave that individual extraordinary structural power. See the Party Constitution in: Teng-hui Lee, *Zhigong Zhicheng de Zhongguo Guomindang* [The Nationalist Party: Unbiased and Complete] (Taipei: KMT Party History Committee, Kuomintang, 1994), p. 309-330. This remained a constituent feature of intra-KMT politics well into the late 1990s.

to a strict line of command extending all the way to the top.[33] With the introduction of these elements, the Generalissimo eradicated any remnant of internal democracy in the party's system of 'democratic centralism,' overcoming what many in the KMT saw as the basic schizophrenia of Sun Yat-sun's original model.[34] While the Chair's position of ultimate power implied that the individual preferences of Chiang Kai-shek, and later Chiang Ching-kuo (*Jiang Jing-guo*) and Lee Teng-hui (*Li Deng-hui*),[35] had a strong impact on policy choice, this power was never arbitrary and self-referential in the mode of Hitler, Stalin or Mao. The role was more akin to what I would call an 'authoritative balancer.' Within a limited range, the supreme leaders of the KMT tolerated intra-party competition on policy questions, and in exercising choice sought to justify their decision and placate intra-party rivals.[36] Official KMT ideology, the experience of the party's rule on the mainland and to some degree the personalities of the individuals concerned meant that the KMT Chair ruled through the party rather than over it.[37]

The centralist structure of the ruling party shadowed the various levels of the state and the security apparatus on Taiwan, and dominated the decision making process at each level. Personnel in the RoC government were usually the same in corresponding offices such that positions within the party and state hierarchies were often distinguishable only in name. That is to say, the KMT Chairman was typically the RoC President, the Standing Committee of the KMT typically included most of the key personnel in the Executive Yuan, and so on down the line.[38] The party organization within the security apparatus included partisan operatives in the military and the infamous Taiwan Garrison Command. Established on the principle of 'the

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[33] After Cheng, I use the term 'quasi-Leninist' as the Kuomintang differed from other Leninist parties in some important respects. While in organizational terms the ruling Party bore strong resemblance to other Leninist parties in the Soviet Union and Eastern Europe, the Kuomintang was not as attached to the cause of revolution as these sibling parties, nor was it as ideologically driven. See: Tun-jen Cheng, 'Democratizing the Quasi-Leninist Regime in Taiwan' in *World Politics* Vol. 42, No. 4 (July 1989), esp. p. 475-480.

[34] Cheng Wang, *The Kuomintang: A Sociological Study of Demoralization* (New York: Garland Publishing Inc., 1982), p. 166.

[35] And we do have some knowledge of what these preferences actually were. For material on economic policy, see respectively: Kai-shek Chiang, 'Zhongguo Jingji Jieshuo' [Theory of the Chinese Economy] in *Jiang Congtong Ji* [President Chiang Kai-shek's Collected Works], Vol. 1 (Taipei: Guofang Yanjiuyuan Chuban, 1963); John Fei, 'The Taiwan Economy in the Seventies' in Shao-chuan Leng (ed.), *Chiang Ching-kuo's Leadership in the Development of the Republic of China on Taiwan, Vol. 3 of the Miller Center Series on Asian Political Leadership* (Lanham, Maryland: University Press of America, 1993); and Yang-gang Lin, Teng-hui Lee, Chuang-huan Qiu (eds.), *Chongxiu Taiwansheng Tongzhi* [Revitalizing Taiwan's Common Vision], Vol. 4 (Taichung: Taiwan Wenxian Weiyuanhui, 1989), pts. 1a & 1b.

[36] The term 'authoritative balancer' implies that while the KMT Chair had an undisputed capacity to bring his preferences to the decision-making process, this capacity coexisted (perhaps uncomfortably) with an important arbitrating and mediating role. I introduce the term to get away from the perception of the KMT Chair as a dictator. Clearly, none of the individuals mentioned above ruled in a fashion similar to Stalin, Hitler or Mao. Comparisons with the wily Bismarck are probably more appropriate. I am indebted to various discussions with Heather Rae, Chris Rhys-Smit and Greg Noble for development of the concept.

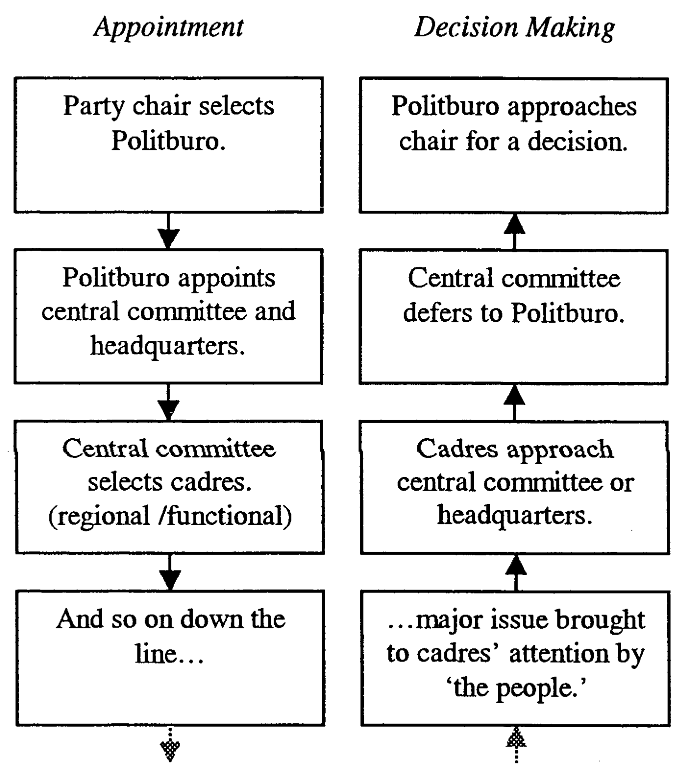
[37] See: Peter R. Moody Jr., *Political Change on Taiwan: A Study of Ruling Party Adaptability* (New York: Praeger, 1992), esp. p. 25-31. Of the literature that addresses the issue of the KMT Chair's level and style of authority, Moody's work is probably the most convincing, and certainly the most pleasing in an aesthetic sense.

[38] Tien, *The Great Transition*, fn. 3, chp. 1 & 4.

party leads the forces' (*yidang lingjun*), party ties to the security apparatus were far more encompassing than arrangements in the civilian bureaucracy. Implemented with the assistance of a corp of committed political officers, these links ensured that party-military relations were remarkably peaceful and stable over time. With only one short-lived exception – i.e. General Wang Sheng in the early 1980s – the military remained politically quiescent during the entire period of KMT rule on Taiwan.[39] The ruling party's shadow character was affected little by the passage of time. While the Nationalists presided over major changes in the procedural form of the party, state and security apparatus – most notably the process of 'Taiwanization' commenced by President Chiang Ching-guo during the 1970s, and the democratic reforms of the 1980s – well into the late 1990s the KMT hierarchy remained the unofficial locus of power and the final arbiter in matters of policy choice.

DIAGRAM 2.3 Leninist organization theory

In a Leninist political party, appointment to positions in any sub-division of the party is performed by an immediate superior. This raises problems regarding selection of the top post. Decision-making follows a chain of referral from the bottom up. This generates a continual search for the authority to act.



Sources: Marcel Liebman [trans. Brian Pearce], *Leninism Under Lenin* (London: Merlin Press, 1980), esp. chp. 2; John P. Roche, *The History and Impact of Marxist-Leninist Organizational Theory* (Washington: Institute for Foreign Policy Analysis, 1984), esp. 13-27; and Melvin Croan, 'The Leading Role of the Party: Concepts and Contexts' in Andrew C. Janos (ed.), *Authoritarian Politics in Communist Europe: Uniformity & Diversity in One-party States* (Berkeley: Institute of International Studies, 1976).

Internally and externally, the primary mechanism of organization and control employed by the KMT was the party cell (*Guomindang xiaozu*). This was an organizational form the KMT leadership copied from the Chinese communists and used to penetrate virtually every group in Taiwan civil society. Where civic organizations did not exist to be penetrated by party cells, the KMT often created them from scratch to ensure maximum control over all established and

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[39] Hsiao-shih Cheng, *Party Military Relations in the PRC and Taiwan* (Boulder: Westview Press, 1990), esp. chp. 2 & 6.

emergent social groups. The most obvious of these KMT 'front organizations' were the plethora of industrial associations created to incorporate business, the professions and labor, but the party also manufactured passive civic organizations in the arts, entertainment, education and sport.[40] KMT cells received logistical and material support from party headquarters (*Guomindang Zhongyangdangbu*) – the ruling party's secretariat and brains trust. Links between the coffers of party headquarters and those of the state – based on the assumption that the material resources of the country were in large measure the resources of the party (*guoku tong dangku*) – furnished the cells with a variety of positive incentives to keep party members in check.[41] The KMT's emphasis on control and pragmatism rather than mobilization and ideology, meant that party membership through cell ties was fairly loose for most people. Indeed, occasionally cell ties and organizational activities produced adverse and unintended effects. Local factions (*difang pixi*) were an outcome of the party's early decision to allow a semblance of democracy on the island, and arose spontaneously as party cells strived to develop close ties at the community level. Often organized around important local families and cliques, most factions were blissfully unconcerned with the ruling party's national agenda and focused entirely on issues of importance to local party members. Despite numerous attempts over the years to bring them closer to the KMT at the national level, local factions became increasingly independent and in many instances tainted with corruption (so-called 'black-gold' *heijin* politics).[42]

In chapter 1 I introduced the concept of the party political 'window of opportunity' and briefly mentioned how the emergence of these fractures within the KMT influenced the course of RoC financial liberalization. In light of the general remarks on the character of the KMT given above, what can we say about the original context of these windows? Two points regarding the KMT's dirigiste policy preferences are worthy of comment. To begin with, although senior figures within the KMT were more receptive to calls for responsible economic management after the flight to Taiwan, this proclivity was limited by the KMT's need to create and maintain a social support base on the island. The circumstances of the ruling party's retreat

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[40] There is only one major study of Taiwan's multitude of industry organizations and other 'non-government organizations' covering the period of relevance to the present work. See: Cheng-tian Kuo, *Global Competitiveness and Industrial Growth in Taiwan and the Philippines* (Pittsburgh: University of Pittsburgh Press, 1995). Kuo argues that after the 1970s the activities of Taiwan's peak industry associations were essentially the product of corporate demands rather than KMT directives. However, Kuo's analysis has difficulty divorcing the associations' behavior from KMT preferences. For a critical review of Kuo's book, see: Stephan Haggard, 'Review of *Global Competitiveness*' in *Pacific Affairs* Vol. 69, No. 3 (Fall 1996).

[41] See for example: Bruce, J. Dickson, 'The Kuomintang before Democratization: Organizational Change and the Role of Elections' in Hung-mao Tien (ed.), *Taiwan's Electoral Politics and Democratic Transition: Riding the Third Wave* (Armonk: M.E. Sharpe, 1996).

[42] Work on KMT local factions is a growth industry. See esp.: Ming-tong Chen, *Paixi Zhengzhi yu Taiwan Zhengzhi Bianqian* [Factional Politics and Taiwan's Political Development] (Taipei: Mingdan Chubanshe, 1995). See also: Ming-huang Liu, 'Zhongyang yu Difang Zhengzhi Quanli Guanxi zhi Zhuanbian: Guomindang Weiquan Zhengti de Gonggu yu Zhuanxing' [Change in Center-Local Power Relations: The Consolidation and Development of KMT Authoritarianism], unpublished PhD manuscript, National Chengchi University, Taipei (1996).

to Taiwan in the late 1940s meant that the KMT regime was an émigré administration.[43] To some extent this was an asset. The KMT's limited connection to the local Taiwanese population (*benshengren*) gave the ruling party a level of policy autonomy that it had not enjoyed on the mainland. But this detachment also meant that the party did not have much of a social foundation to legitimate and perpetuate its rule. The party's mainland experience – in particular the neglect of land reform for the vast population of Chinese peasants – suggested the political folly of disenfranchising the citizenry for too long. The regime knew that to retain power on Taiwan, eventually it had to pursue a course of selective social inclusion.[44]

In part, the KMT's response to this imperative was to construct a broad 'distributional coalition.'[45] Although this coalition changed over time as the RoC economy matured and diversified, the proclivity to 'buy in' or 'pay off' key social groups on Taiwan was a distinguishing and enduring feature of KMT rule. Early on, a critical member of the distributional coalition was the large population of mainland immigrants (*waishengren*) who followed the ruling party to Taiwan at the close of the Civil War. The KMT regime provided for this group through employment in government bureaucracies, the security apparatus and state-owned enterprises.[46] To offset the lower salaries offered in these often-bloated hierarchies compared to the private sector, mainlanders were given job security and limited social welfare provisions. Another early group in the KMT's coalition was Taiwanese farmers. The land reforms of the early 1950s established a system of rural ownership and production that rapidly increased farmers' living standards. In the 1970s, the KMT regime deepened the commitment to rural assistance with a comprehensive program of agricultural protection – a move which locked in farmers as cast-iron votes (or *tiepiao*) for the KMT at a time when elections were becoming increasingly important.[47] One final group that the KMT sought to 'buy in' was labor, although the policies it implemented in relation to this coalition partner were initially circuitous. While labor unions were politically muted by the regime, wages were not suppressed and the ruling party allowed wage gains to keep pace with productivity increases. In the early to mid 1980s, the party moved to expand the provisions for workers' welfare. Much to the chagrin of

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[43] That is, a government in exile with limited ties to the host society. See for example: Yun-han Chu, *Crafting Democracy in Taiwan* (Taipei: Institute for National Policy Research 1992), p. 17. Other writers have claimed that the KMT regime was a colonial power without a metropolitan domicile. This conception, however, begs comparisons with the apartheid government of South Africa – a regime that had no intention or need of building support within the local population. The KMT was far more interested in incorporating the Taiwanese people than the notion of a colonial government suggests.

[44] Tun-jen Cheng and Stephan Haggard, 'Regime Transformation and Comparative Perspectives' in Tun-jen Cheng and Stephan Haggard (eds.), *Political Change in Taiwan* (Boulder: Lynne Rienner Publishers, 1992).

[45] A term coined by Cheng Tun-jen in: Cheng, 'Political Regimes and Development Strategies: South Korea and Taiwan,' fn. 30, p. 168.

[46] See for example: Yun-han Chu, 'State Structures and Economic Adjustment in the East Asian Newly Industrializing Countries' in *International Organization* Vol. 43, No. 4 (1989).

[47] Hsiaofen Hemstock, 'Economic Development: Strategies and Policies in Postwar Taiwan,' unpublished Ph.D. manuscript, Ohio State University (1990), p. 65-92. More on the KMT's agricultural policies in chapter 3.

Taiwan's business interests, severance payments, superannuation, medical care and so on were introduced as a means to keep the labor force happy and pro-KMT.[48]

The KMT regime was more than willing to lend the instruments of financial policy to the task of building social support on Taiwan. The ruling party used financial repression to bolster those industries and commercial pursuits that were mainstays of the party's distributional coalition, and undercut those economic groups that resided outside. We know, for example, that state-owned enterprises, as a key employer of mainland émigrés and their offspring, received preferential access to the national savings pool. Anecdotal reports and quantitative studies both confirm that Taiwan's state-owned banks provided credit at discount rates to public enterprises and offset these outlays by imposing premium rates on corporate customers.[49] Distrust and distance were key features of the KMT's relationship with business on Taiwan, and the island's leading entrepreneurs paid for this political exclusion with (comparatively) expensive capital. Elsewhere, farmers and fishermen's associations, as a key organizational site for Taiwan's rural community, were given exclusive rights to operate community credit cooperatives. These institutions were used and abused in a most imprudent fashion; coop funds were poured into everything from local election campaigns to private construction projects for leading district personalities (the crossover with local factions here is important and will be explored later). Not surprisingly, the credit cooperatives carried the bulk of bad loans in Taiwan's financial system – a condition that was further entrenched with every successive government bailout.[50]

The discussion above confirms that the KMT's concern with building a social support base on Taiwan informed at least some of the ruling party's outlook on financial policy (with decidedly illiberal results). This broad socio-political calculus was, however, only part of the story. The other half of the equation was more narrowly defined and tied to the KMT's specific sectoral agenda for finance. The history and character of the ruling party implied that it prioritized financial stability and control as systemic goals. This policy approach was constructed negatively: volatility in financial markets and the loss of administrative prerogative were evils to be avoided at all costs. The desire for stability was closely tied to the KMT's mainland experience. As noted above, the KMT's economic mismanagement on the mainland was largely responsible for the hyperinflation of the 1940s and, in turn, defeat in the Chinese Civil War. On the ground, this monetary environment produced a permanent state of financial insecurity. Runs on financial institutions and capital flight were commonplace as the public sought a safe haven for their savings. The inability of the RoC monetary authorities to rectify

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[48] Cheng, 'Political Regimes and Development Strategies: South Korea and Taiwan,' fn. 30, p. 168-169. See also: *Far Eastern Economic Review* (6 September 1984).

[49] Ya-hwei Yang, 'Taiwan: Development and Structural Change of the Banking System' in Hugh T. Patrick and Yung Chul Park (eds.), *The Financial Development of Japan, Korea and Taiwan: Growth Repression and Liberalization* (New York: Oxford University Press, 1994), p. 294; and interviews in Taipei with officials from various public and private banks, 1996 & 1999.

[50] Ming-hui Wang, 'Cong Wanglu Guanxi Tantao Nonghui Xinyongbu zhi Yunzuo' [A Network Analysis of the Use and Manipulation of Credit Departments in Farmers Associations] in *Si yu Yan* [Ideas and Words] Vol. 31, No. 2 (June 1993).

the mess lead to a loss of business confidence and the cessation of productive investment. The desire for strong control of the financial sector was conditioned by organizational imperatives. As Leninist, covert and authoritarian, the ruling party found that direct administrative control of saving and investment dovetailed well with the overall pattern of KMT rule on Taiwan. The notion of prudential oversight of the financial system would have been an anathema to the regime. Among other things, the ruling party sought to manipulate the Taipei trade in bean curd (through the *Taibeishi Doufu Shangye Tongye Gonghui*). Why would it adopt a hands-off policy towards banks and other financial institutions?[51]

The flipside of the KMT's emphasis on financial stability and control was that questions regarding systemic efficiency and the cultivation of the financial sector as an independent industry were largely ignored. While economic growth became a vital policy goal for the KMT after the 1950s, the particular kind of economic development Taiwan experienced was also important. Expansion of production in tangible goods was encouraged, while growth in intangible services, particularly financial services, was frowned upon. On the mainland, the KMT's reputation had suffered badly through its association with a fledgling class of private financiers. This group, located in the international center of Shanghai, accumulated vast reserves of wealth during the 1930s and 1940s, much of it secured through speculative endeavors and occasionally less than legal means.[52] On Taiwan, commercial vocations (banker, accountant, etc.) were considered of lowly status and typically faced tight curbs on professional conduct. Speculation, whether in the stock market or in real estate, was seen as an illegitimate means of making an income (the Chinese term for speculator, *toujizhe*, is particularly derogatory), and something to be confined to small pockets of the economy.[53] These experiences and perceptions, according to one interviewee, saw the financial sector turned into an armored tank – '...a system intended to withstand the worst of economic crises, but incapable of doing much more than 20 mph on the freeway.'[54]

The KMT's pursuit of the goals of financial stability and control was apparent in a broad cross-section of financial policies prior to the late 1980s. Consider one particularly extreme example. It was briefly noted in chapter 1 that prior to financial liberalization, accounts

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[51] The financial goals of stability and control are enduring themes in the literature. See esp.: Karl J. Fields, *Enterprise and the State in Korea and Taiwan* (Ithaca: Cornell University Press, 1995), chp. 1 & 3; and Tun-jen Cheng, 'Guarding the Commanding Heights: The State as Banker in Taiwan' in Stephan Haggard, Cheng H. Lee and Sylvia Maxfield (eds.), *The Politics of Finance in Developing Countries* (Ithaca: Cornell University Press, 1993). See also: Fu-ming Xu, *Zhongguo Guomindang de Gaizao* [The Reform of the Kuomintang] (Taipei: Zhenzhong Shuju Chubanshe, 1986), esp. chp. 5. Supplemented with material from an interview in Taipei with Chan Chuen-po, Chair of the Taipei Municipal Committee and ex-member of the KMT Central Finance Committee, 16 January 1997.

[52] On the business-KMT relationship on the mainland see: Parks M. Coble Jr., *The Shanghai Capitalists and the Nationalist Government, 1927-1937* (Cambridge, Mass.: Harvard University Press, 1980); and Richard C. Bush, *The Politics of Cotton Textiles in Kuomintang China, 1927-1937* (New York: Garland, 1982).

[53] Interviews in Taipei with economists and finance industry personnel, 1996 & 1999.

[54] Interview with Dr Ray B. Dawn, Director of Financial Research Division, Taiwan Institute of Economic Research, 19 June 1996.

managers in RoC banks were held criminally liable for non-performing loans. Predictably enough, banks preferred collateral in any credit assessment process (and the more liquid the better) and completely ignored business performance and potential as criteria. The rationale for this severe restriction was to prevent the accumulation of bad debt by local banks (a perceived threat to systemic *stability*) and to reduce the range of independent activity by the employees of these institutions (thus maximizing executive *control*). The outcome of this regulatory approach was in keeping with original intentions. Even in years of poor economic performance and financial turbulence, non-performing loans among the state-owned commercial banks (but *only* the state-owned banks) were rarely greater than 0.2% of total loans outstanding. In 1985, with the economy sluggish and the Tenth Credit Cooperative scandal in full swing, bad loans for these particular institutions came in at just 0.16% (with total loans of NT$1.189 trillion and bad loans of NT$1.64 billion). The flipside of these figures was that many efficient and deserving companies were starved of funds, even while a huge pool of bank deposits lay idle.[55]

3. The economic technocrats

Although examining the role and nature of the KMT regime gives us considerable insight into the question of *who governed in financial policy*, it leaves us with little indication of how financial policy might have changed over time. Where is the potential for dynamism in this model? How did new policy ideas arise? To address these queries, we need to look at one key constituency in the KMT's hierarchy of power: the economic technocrats.

Located within the upper-reaches of the RoC state's administrative machinery was a small but respected group of technocrats in control of economic policy – a group I have chosen to call, after Samuel Ho, the 'economic technocrats.'[56] As noted by Wade, economic policy making in Taiwan during the post-War era was '...dominated by scarcely more than a dozen people.'[57] The economic technocrats (*jingji guanliao* or *jishu guanliao*) were a fluid group of 'proximate decision makers' occupying government economic portfolios or in positions closely related to these offices.[58] In the period of relevance to this thesis, we can point to three main sub-groups within the general category. First, there were those core members of the economic technocracy who maintained formal responsibility for a small number of key economic ministries and commissions. This group included the Ministers of Finance and Economic Affairs, the governor of the Central Bank of China and the Chair of the Council for Economic Planning and

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[55] See esp.: Willis Ke, 'Slowed Economy, Scandals Affect Profits But Also Speed Reform' in *Financial and Investment Yearbook, RoC 1986* (Taipei: Central Economic News Service, 1986). See also: Willis Ke, 'Earnings are Down, But Improvements Under Way' in *Financial and Investment Yearbook, RoC 1985* (Taipei: Central Economic News Service, 1985).

[56] Samuel P.S. Ho, 'Economics, Economic Bureaucracy and Taiwan's Economic Development' in *Pacific Affairs* Vol. 60, No. 2 (Summer 1987).

[57] Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton: Princeton University Press, 1990), p. 217.

[58] Robert D. Putnam, *The Comparative Study of Political Elites* (Englewood Cliffs, N.J.: Prentice Hall, 1976), chp. 1.

Development. Surrounding this core were officials hailing from a series of government agencies with tangential or contingent responsibility for economic issues. Among this peripheral group of elites we can include the Director General of Budgets, Accounts and Statistics, the Minister of Transport and Communications, the Chair of the Securities and Exchange Commission, the Commissioner of the Provincial Government Department of Finance, and one or two others. And finally, in addition to the elites described above, there were also several 'shadowy' individuals who drifted in and out of the sub-groups already described. We can include in this floater group the Premier, a number of senior 'Ministers of State,' a number of exceptional junior technocrats (including vice ministers, divisional directors, bureau chiefs, etc.) and several economic advisors (usually academic economists) drawn into the policy process on a case-by-case basis.[59]

It is tempting, like Wade and Ho, to see the economic technocrats first and foremost as exceptional civil servants with an unqualified commitment to good policy (however defined).[60] It is also tempting, after Liang and others, to see the group as a simple extension of KMT politics and power.[61] However, both of these interpretations oversimplify the reality of the economic technocrats' vocation. The truth is much more complicated and much more interesting: the economic technocrats were at one and the same time competent and independent policy technicians *and* partisan cadres. That is, the technocrats were both white and expert (in contrast to the 'red over expert' bias extant in communist China). On the one hand, the high level of competence of the economic technocrats cannot be denied. While specific quantitative data on the group is difficult to assemble, sufficient biographical information exists to make the case that they were highly educated and experienced in their areas of policy interest. Consider the profiles of three technocrats mentioned by name in chapter 1 – Li Kwoh-ting, Yu Kuo-hua and Shirley Kuo.[62] Li Kwoh-ting, prior to retiring from the limelight in the late 1970s, was Minister of Economic Affairs and Finance from 1965 to 1976, and throughout the 1980s held a number of positions on distinguished advisory committees. His educational background was in science and included exchange positions at the Royal College in London, Cambridge University and a dozen other leading international universities. By the time he became Premier in 1984,

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[59] These groups are variously suggested in: Ho, 'Economics, Economic Bureaucracy and Taiwan's Economic Development,' fn. 56; Walter Arnold, 'Bureaucratic Politics, State Capacity and Taiwan's Automobile Industry Policy' in *Modern China* Vol. 15, No. 2 (April 1989); Y. Dolly Hwang, *The Rise of a New World Economic Power: Postwar Taiwan* (New York: Greenwood Press, 1991), chp. 5; and Gregory W. Noble, 'Contending Forces in Taiwan's Economic Policymaking: The Case of Hua Tung Heavy Trucks' in *Asian Survey* Vol. 27, No. 6 (June 1987).

[60] Wade, *Governing the Market*, fn. 57, p. 217; and Ho, 'Economics, Economic Bureaucracy and Taiwan's Economic Development,' fn. 56.

[61] Shuang-lian Liang, 'Zhongyang Xingzheng Jiguan Gongwu Renyuan Zhizu Rentong de Yanjiu' [Party Identification of Public Servants in the Central Administration] unpublished Ph.D. manuscript, Department of Political Science, National Taiwan University, Taipei (1984).

[62] The purpose of this chapter's discussion is to briefly introduce the economic technocrats *as a group*. As a consequence, only passing reference will be made to particular individuals where appropriate. More detail on specific members of the technocrats will be provided in the case study chapters – including additional information on the three individuals mentioned here.

Yu Kuo-hwa had 14 years experience in the finance industry (both in the RoC and elsewhere); 20 years as Central Bank governor, Minister of Finance and chair of the Council for Economic Planning; and periods as director of the World Bank and Asian Development Bank. He held an honorary doctorate in finance from St. Johns University in New York, and earlier in his career had been a visiting fellow to Harvard and the London School of Economics. Finally, despite being a relative latecomer on the scene, Shirley Kuo had a dynamic career as an economics professor, deputy chair of the Council for Economic Planning and deputy governor of the Central Bank before becoming Finance Minister in 1988. Her educational background was in economics, and included a Ph.D. from Kobe University in Japan conferred in the early 1980s.[63]

Beyond these brief biographical histories, the broad data on personnel in the RoC civil service also suggests the economic technocrats were a team to be reckoned with. We know, for example, that the public sector in Taiwan (including central government ministries, commissions and public enterprises) persistently absorbed greater numbers of Masters and Doctoral graduates than the private sector throughout the 1970s and 1980s. In the early to mid 1980s, for example, around 23-26% of higher-degree graduates entered government service, as compared with 20-23% for business and around 40% for academia (the remainder described as 'others' including positions taken up abroad). Further, we also know that around 50% of staff in the economic ministries possessed a Bachelors degree or better (compared to 10% for the population as a whole at that time). We could justifiably assume that this ratio was considerably higher in the upper reaches of the bureaucratic pyramid. Moreover, the ratio of civil service absorption of students returned from overseas study (so-called *haiwai xueren*) was between 10-15% in the first five years of the 1980s (a group which represented much less than 0.01% of Taiwan's population). This figure was commensurate with the absorption rate of the private sector, but well behind academia. Correlating estimates provided in interviews place the number of senior staff who were returned students in the order of 50-60%, although it was noted that these figures were declining through the 1980s and beyond (as increased opportunities opened up in the private sector).[64] Taken together, these figures suggest that the average member of the economic policy elite was at least a university graduate, and more than likely a

[63] From: *Zhonghua Minguo Mingrenlu, Minguo 88 Nian* [Who's Who in the RoC] (Taipei: Central News Agency, 1999). See also: *Republic of China Yearbook, 1996* (Taipei: Government Information Office, 1996).

[64] See variously: Wade, *Governing the Market*, fn. 57, p. 217-224; Chien-kuo Pang, 'The State and Economic Transformation: The Taiwan Case,' unpublished Ph.D. manuscript, Brown University (1988), esp. p. 62-63; *Minguo 73-74 Nian Daxue yu Zhuanke Biyesheng de Zhiye Baogao* [Report on the Employment of University and College Graduates, 1984-85] (Taipei: National Youth Commission, Executive Yuan, 1987); *Taiwan Statistical Data Book, 1996* (Taipei: Council for Economic Planning and Development, Executive Yuan, 1996); and various personnel statistics from Central Bank of China, Ministry of Finance, Ministry of Economic Affairs – see for example *Caizhengbu ji Suoshu Jiguan Linian Gongfu ji Shiye Renyuan Renshu* [Personnel Statistics of the Ministry of Finance and Subsidiary Agencies in Recent Years] (Taipei: Department of Personnel Affairs, Ministry of Finance, 1995). Augmented with interviews with civil servants in Taipei, 1996 and 1999.

holder of a higher degree. The KMT regime *did not* simply promote ignorant cronies: the economic technocrats were among the best and the brightest Taiwan had to offer.[65]

On the other hand, the strong partisan character of the economic technocrats cannot be denied either. To begin to appreciate the truth of this statement, we need to distinguish theory from practice in technocrat recruitment and promotion. According to formal government regulations, RoC ministries and executive commissions were constructed along classical Weberian lines similar to Japan. The Examination Yuan and the Central Personnel Administration of the Executive Yuan were supposed to have comprehensive responsibility for appointment and promotion of all RoC civil servants. In theory, this was to be conducted strictly on the basis of performance in entrance exams and periodic review. The only exceptions were supposed to be the minister and political vice-minister at the very top. These positions were always assumed to be political appointees in line with established ideas about responsible government.[66]

But despite the best intentions of government propaganda, very few people in Taiwan actually believed any of the above. In reality, the average ministry or commission was divided into three semi-institutionalized strata, with radically different processes of recruitment and advancement at each level (see Diagram 2.3 for an overview). At the very bottom of the pyramid there were the basic line staff that entered the bureaucracy with a high school diploma or better. They were recruited to the civil service on the basis of the annual 'common exam' (*putong kaoshi* or just *pukao*) managed by the Examination Yuan, and moved up according to a mix of seniority and merit. There was little lateral movement of these individuals between departments, and they were rarely invited to move into the second tier of the bureaucracy. This first tier best exemplifies the Weberian model propounded in government regulations and publicity. The second tier – mostly middle management positions and researchers – was reserved for university graduates with a ranking score in the annual 'high-level exam' (or *gaokao*). For these people, however, the entrance test was only partially important. Technical skills, performance in an interview, and to some degree political affiliation to the KMT were ultimately determinant. Second tier bureaucrats could expect to move up into the third tier given good performance and the right aptitude (i.e. pro-KMT), and occasionally sideways into other government departments. Finally, the third tier was usually reserved for highly qualified and highly experienced personnel from elsewhere in government. It included the minister, the

[65] This point cannot be over-emphasized: KMT stalwarts without sufficient qualifications or experience were *never* promoted over the best and brightest – i.e. there were limits to the extent to which the party 'shadowed' the state. The classic example here is Ma Ying-jeou's father, Ma He-ling. Despite rising to senior positions within the party hierarchy, the elder Ma failed to ascend the ranks of the state apparatus. I am indebted to Dr Kuo Chiang-tian for bringing this example to my attention.

[66] As laid out in the various rules, regulations and reports of the two personnel agencies mentioned. See for example: *Renshi Xingzhengju Jianjie* [Introduction to the Central Personnel Administration of the Executive Yuan, RoC] (Taipei: Central Personnel Administration, Executive Yuan, 1998); and *Zhonghua Minguo Renshi Faze* [Personnel Regulations of the RoC] (Taipei: Central Personnel Administration, Executive Yuan, 1998), esp. sect. 1.

political and administrative vice ministers, directors of ministerial departments and a significant number of policy support staff. Although it is difficult to demonstrate quantitatively, everyone I interviewed agreed that appointment and promotion in the illusive third tier virtually always had a political component. Non-KMT personnel would occasionally be admitted, but those with dissenting views would stand no chance. Third tier personnel would *often* rotate between ranking positions in other government departments, academia, policy think tanks, state-owned enterprises and various internal commissions of the ruling party. This career loop rarely included a period in private industry, although this pattern had begun to change by the early 1990s.[67]

The patterns of recruitment and promotion outlined above confirm that while many personnel decisions in the RoC state were guided by merit and seniority, party politics strongly dictated choice in at least the top third of the civil service. As members of the top strata, the economic technocrats invariably had ties to the ruling party, and ultimately owed their career progress to KMT affiliation. What was the nature of this link to the ruling party? From the point of view of many if not most economic technocrats, KMT membership was *not* a matter of heartfelt ideological or nationalist commitment (of a type we might expect from party affiliation in other developing countries or communist China). The technocrats saw membership of the ruling party largely as a question of career advancement and elite admission. In colloquial terms, KMT affiliation was 'a good way to make money and contacts'[68] rather than a means to promote some abstract political agenda. Just so long as KMT members were prepared to toe the party line when called upon to do so, they were permitted considerable latitude to think and say what they wished. In response to a question about the nature of KMT membership, Professor Chen Ming-tong from National Taiwan University commented: 'Only a small proportion of KMT members *actually consider themselves party identified; around 15%....* It's probably best to think of the KMT as a small central core surrounded by a mass of fragmented supporters with only passing interest in the party's platform or ideological concerns.'[69] This 'tacit' character of KMT membership meant that the ruling party could accommodate a wide cross-section of people within its ranks – including a cohort of capable and independently-minded technocrats.

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[67] For these points, I am especially indebted to: Prof. Ye Kuang-shi, Lecturer in Organization and Human Resources at the Department of Business Management, National Sun Yat-sen University – interview in Taipei, 28 February 1999; and Dr. Wang Hong-zen, Official from the Board of Foreign Trade, Ministry of Economic Affairs – interview in Taipei, 5 March 1999. For more general points along the same theme, see also: Jun-shu Chang and Jermain Lam, 'Public Administration in Taiwan: Development, Challenges and the Future' in Ahmed Shafiqul Huque, Jermain T.M. Lam and Jane C.Y. Lee (eds.), *Public Administration in the NICs: Challenges and Accomplishments* (New York: St. Martins, 1996); and Milan Tung-wen Sun, 'Public Administration in Taiwan: The State of the Art,' unpublished Ph.D. manuscript, Kent State University, Ohio (1992). Note also Lien Chan's career path as outlined in: Chan Lien, *Heading for the 21st Century* (Taipei: Government Information Office, Executive Yuan, 1994), p. i-vi.

[68] As one party member remarked (somewhat disconcertingly) in an interview. Interview in Taipei with Lin Zong-jie, Party Historical Committee, Kuomintang, 6 May 1999.

[69] Emphasis added. The low figure for party identification Chen quotes is quite astonishing – in most Western countries this level of party identification is probably more indicative of the *whole population*

As one policy commentator in Taiwan remarked in an interview: 'It must be emphasized that the ruling party had no real problem filling these positions [senior economic portfolios] with its own. Throughout government and academia there were literally hundreds of potential candidates; why would the KMT choose a person who wasn't a party member?!'[70]

But what did the technocrats' partisan ties ultimately mean for the group's policy outlook? Regardless of the tacit character of KMT affiliation, loyalty to the ruling party often meant that the economic technocrats' were presented with a philosophical and practical policy dilemma. Just as an ambassador is a 'an honest man sent abroad to lie for his country,'[71] the technocrats were a group often at odds with the dirigiste economic policies placed in their care. As previously described and explained, the KMT regime traditionally favored the maintenance of a high level of government control over the economy and a highly repressed financial system. Indeed, the political priorities of the ruling party meant that it was decidedly illiberal in many of its policy preferences. The same cannot be said, however, for the economic technocrats within the ruling party's ranks. Although this group by no means favored Taiwan becoming a laissez-faire economy in the style of Hong Kong or Singapore, it is apparent that they did not have the same 'fear and loathing' (or at least chronic disregard) of markets that distinguished the KMT's overall outlook. By the early to mid 1980s, the economic technocrats were marked by three consistent principles of economic and financial policy – principles which confirm the group had a lot more in common with Adam Smith than is usually acknowledged,[72] and placed these elites at a distance from the political party to which they owed their allegiance.

To begin with, the economic technocrats were strong believers in the utility of an economic system based on free enterprise. They saw private property, the price mechanism, the profit motive, competition and voluntary exchange in goods and factor markets as fundamental building blocks of a prosperous economy. While many of the technocrats saw market failure and the circumstances of late development as important factors requiring qualification of free enterprise – arguments especially typical of K.Y. Yin's generation of policy elites – the group was adamant that such curbs on economic freedom should be limited in scope and only admissible on strict economic criteria.[73] Insofar as free enterprise was the ultimate source of national prosperity, the technocrats placed great emphasis on prudent monetary and fiscal policy

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rather than *actual members* of a particular party. Interview in Taipei with Professor Chen Ming-tong, Sun Yat-sen Graduate Institute, College of Law, National Taiwan University, 5 March 1999.

[70] Interview in Taipei with Professor Ye Kuang-shi, Lecturer in Organization and Human Resources at the Department of Business Management, National Sun Yat-sen University, 28 February 1999.

[71] A famous line by British poet Sir Henry Wotton, 1568-1639.

[72] There is a tendency for analysts to try and find a 'different' (read 'non-Western') model of capitalism in the technocrats' ideas and works. Often they succeed by virtue of reifying KMT preferences, or overemphasizing some of the more exotic thinking that occasionally held currency in the group. See for example: Alan P.L. Liu, *Phoenix and the Lame Lion: Modernization in Taiwan and Mainland China 1950-80* (Stanford: Hoover Institution Press, Stanford University, 1987), chp. 3.

[73] Chung-yung Yin, *Wo Dui Taiwan Jingji de Kanfa* [My Views on Taiwan's Economy], Vol. 1 (Taipei: Economic Planning Council, Executive Yuan, 1973), chp. 1, esp. p. 29. See also: Mo-huan Xing, *Tongshu Jingji Jianghua: Guannian yu Zhengce* [Popular Lectures on Economics: Concepts and Policies] (Taipei: Sanmin Chuban, 1986), various chapters.

to provide a stable basis for entrepreneurial activity, and were extremely reluctant to compromise such prudence with grandiose plans of development (*à la* South Korea in the 1970s). Tied to this position, the technocrats were strong advocates of the view that interest rates should approximate the real cost of capital, and saw allocation of subsidized funds as a policy deviation not a standard. Although it is true the technocrats believed financial institutions were a special category of enterprise – possibly requiring government ownership – they were equally committed to the notion that banks and other financial concerns should be economically efficient and effective. That is, even if they were not private enterprises, they should strive to achieve the same level of competitiveness.[74]

Second, by and large the economic technocrats were even-handed on the desirability of government intervention in the economy. They saw a major role for government in human resource development (education and health services), and deemed the provision of infrastructure (from business law to port facilities) as among the most important of public tasks. Beyond these basics, however, the technocrats believed that government intervention should be decided strictly on a case-by-case basis where market failures or unequivocal development interests could be demonstrated. Even those technocrats with a strong commitment to (indicative) planning – e.g. Li Kwoh-ting – assumed that government intervention had a use-by date. It was probably not justifiable over the long term, and certainly not commensurate with the RoC's ultimate transition to a developed economy.[75] This agnosticism on government intervention is exemplified in the technocrats' attitude toward the key flows of the financial system – i.e. savings and investment. Beyond the question of fiscal policy, the technocrats approached the issue of savings in terms of indirect government encouragement (witness the postal savings system) rather than forced collection (as promoted in Singapore, Malaysia and a host of Western countries). As for investment, by the early 1980s the technocrats had lost much of their earlier enthusiasm for large-scale public projects (e.g. the 10 Major Projects, *Shida Jianshe*) and were calling for a significant and enduring increase in the private allocation of funds.[76]

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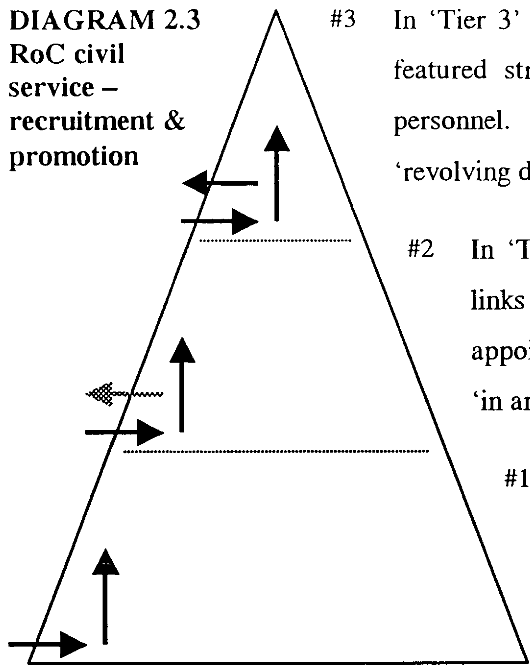
[74] Kuo-ting Li, *The Evolution of Policy Behind Taiwan's Development Success*, 2nd ed. (Singapore: World Scientific Publishing Company, 1995), esp. chp. 2, 3 and 9; and Kuo-ting Li, 'The Evolution of Fiscal Policy in Taiwan' in *Industry of Free China* Vol. 80, No. 5 (1993). See also: personal interview with Yu Kuo-hwa in Diane Ying (ed.), *Juecezhe* [Decision Makers] (Taipei: Commonwealth Publishing Co., 1983), esp. p. 23-26.

[75] Kwoh-ting Li, *Economic Transformation of Taiwan, RoC* (London: Shepheard-Walwyn Publishers, 1988), esp. various chapters in section 1. See also: Philip Li, 'A Conversation With T.H. Lee, Minister of Economic Affairs' in *Financial and Investment Yearbook, RoC 1987* (Taipei: Central Economic News Service, 1987).

[76] Shirley W.Y. Kuo, *The Taiwan Economy in Transition* (Boulder: Westview Press, 1983), chp. 2 & 15; Shirley W.Y. Kuo, 'The Taiwanese Economy in the 1990s' in Gary Klintworth (ed.), *Taiwan in the Asia-Pacific in the 1990s* (St Leonards: Allen & Unwin, 1994), esp. p. 92-99; Paul C.H. Chiu, 'Money and Financial Markets: The Domestic Perspective' in Gustav Ranis (ed.), *Taiwan: From Developing to Mature Economy* (Boulder: Westview Press, 1992); and Li-teh Hsu, 'Wo Guo Caizheng Yinggai Nuli de Fangxiang' [Priority Tasks for Finance Policy – a public lecture presented at National Chengchi University] in Li-teh Hsu, *Xiandai Caizheng Zhengce Lunshuo* [Fiscal Policy] (Taipei: Ministry of Finance, 1984).

DIAGRAM 2.3 RoC civil service – recruitment & promotion



\#3 In 'Tier 3' positions in the RoC civil service, KMT links featured strongly in the appointment and promotion of personnel. Staff often entered and existed via a lateral 'revolving door.'

\#2 In 'Tier 2' positions, party political affiliation and links featured alongside merit and seniority in appointment and promotion. Staff generally moved 'in and up.' Some lateral movement.

\#1 In 'Tier 1' positions, merit and seniority were primary in appointment and promotion. Staff could only expect to move 'in and up' to top of the tier.

Sources: Interviews in Taipei, 1999. See also: Jun-shu Chang and Jermain Lam, 'Public Administration in Taiwan: Development, Challenges and the Future' in Ahmed Shafiqul Huque, Jermain T.M. Lam, and Jane C.Y. Lee (eds.), *Public Administration in the NICs: Challenges and Accomplishments* (New York: St. Martins 1996); and Milan Tung-wen Sun, 'Public Administration in Taiwan: The State of the Art,' unpublished Ph.D. manuscript, Kent State University, Ohio (1992). Compare with various regulations in *Zhonghua Minguo Renshi Faze* [Personnel Regulations of the RoC] (Taipei: Central Personnel Administration, Executive Yuan, 1998).

Finally, the economic technocrats exhibited a strong faith in good science as the basis for good policy. Much has been made of the fact that there were divergent streams of thinking on economic policy among the technocrats based on disciplinary boundaries. They came to the task of policy management with backgrounds in engineering (e.g. Sun Yun-suan), social science and economics (Yu Kuo-hua) and the hard sciences (Li Kwoh-ting), a fact which occasionally lead to disagreement.[77] This said, my research reveals that such disputes were insignificant when compared to the sense of *esprit de corps* generated by a shared experience of advanced education (still rare in Taiwan in the early to mid 1980s) and a common dedication to public service. Faith in scientific method also lead to mutual respect among the various streams; they were more often than not inclined to see each other as complimentary rather than competing.[78] Applied to the realm of financial administration, the ideological attachment to science gave rise to an almost obsessive desire to accumulate research about the RoC financial system. Often facilitated through the group's links with academia, the technocrats conducted a plethora of studies into the local financial sector and had a firm grasp of the system's ignoble character and

[77] Wade, *Governing the Market*, fn. 57, p. 217-224.
[78] Various interviews in Taipei with officials from the Ministry of Finance, Ministry of Economic Affairs, Central Bank of China, and Council for Economic Planning and Development, 1996 & 1999.

operations.[79] When financial reform became a real possibility in the late 1980s, the technocrats were well armed with the latest research and statistics.

Although the comments above imply a basic unity in the outlook of the economic technocrats, members of the group approached specific policy issues – including financial liberalization – in different styles, and with different resources and concerns. We will see in the case study chapters that the technocrats had specialized roles in financial opening, dividing roughly into three subgroups over the three main waves of reform. Nonetheless, the team was united in their fundamental philosophical position. As we have seen, this position was quite liberal on rudimentary questions regarding 'good' economic and financial policy. Accepting this point leaves us with one final, somewhat speculative question: Why were the economic technocrats more liberal in their policy outlook than the political party to which they were ultimately responsible? To some degree, the policy preferences of the technocrats were simply an outcome of their education and training. Many of the group, as previously noted, were returnee students and professionals from the US and Europe – a background which gave them a strong theoretical and working knowledge of the relatively open economies and financial systems of the West. Although it is by no means axiomatic that this insight would translate into more market-orientated policy preferences, my research interviews suggest that there was indeed some link between the two. This may explain the tendency for returnees to gravitate toward more liberal government agencies – for example, the Securities Exchange Commission – rather than conservative ones.[80]

Another reason for the technocrats' comparatively liberal outlook was more practical: the day to day administration of the KMT's dirigiste priorities created real problems for those who actually had to translate preferences into policy. In large measure, the ruling party's policy agenda was a negative guide on what to avoid, rather than a positive prescription of what to do – a recipe for indecision and vacillation highlighted in every management text since Drucker wrote his seminal book.[81] As one senior policy commentator remarked with reference to the recent past: 'I think [the bureaucrats responsible for finance have been] confused about what they are doing, and as such they seem to continually fall back on this idea that they have to avoid any kind of disruption to market "order." This damage control mentality is in fact self-fulfilling: by refusing to provide direction and constantly looking for the next disaster they

[79] Indicative of this thoroughness, the technocrats even had a firm grasp on the nature of Taiwan's black and grey financial markets. For many years, the government published figures on interest rates in the curb market and commissioned regular studies on the operation of various underground financial institutions. See for example: *Taiwan Diqu Minjian Hehui Xiankuang zhi Yanjiu* [Research Report on the Current Condition of Rotating Credit Rounds in Taiwan] (Taipei: Ministry of Justice, 1985).
[80] Various interviews in Taipei with civil servants in the Central Bank of China, Ministry of Finance and Securities Exchange Commission, 1996 & 1999. See also my newspaper articles broaching this topic: Wu, 'New Directions, Here and Abroad: An Interview with Benny Hu,' fn. 17; and Kui-ke Wu, 'Foreign Policies: Foreign Insurance Companies in Taiwan' in *China Post* (9 December 1996), p. 11.
[81] That is: Peter F. Drucker, *The Practice of Management* (London: Heineman, 1956).

actually create new problems.'[82] We can reasonably assume that the smarter members of our economic technocracy would have found this lack of direction rather burdensome.

Conclusion

In the broader scheme of this study, the purpose of the present chapter is really quite pedestrian: that is, to provide an overview of the basic 'nuts and bolts' information which underpins the story of Taiwan's three waves of financial liberalization in the late 1980s. In the first section of the chapter I conducted a brief review of the institutional context of financial policy in Taiwan. This section included general material on the character of the RoC state, the regulatory authorities immediately responsible for finance and the formal process of financial policy change. The second section of the chapter was dedicated to introducing the KMT, the ruling political regime in Taiwan over the period of financial reform and beyond. In this section I presented information on the ideology, structure and composition of the ruling party, and examined in some depth the party's dirigiste financial policy preferences. Material on the policy preferences was offered in the context of the two 'policy windows' detailed for the first time in chapter 1 – the socio-political window and the sectoral-strategy window. And finally, in the last section of the chapter I considered some of the key features of the economic technocrats. In particular, I assessed the academic debate surrounding their general character – experts versus party stalwarts – and gave due attention to their policy preferences. It was noted in this section that the policy outlook of the economic technocrats was considerably more liberal than that of the overall KMT regime.

Having considered this background information, we can now turn our attention to more engaging matters. The task before us is to test the technocrat leadership theory of financial liberalization. In chapters 3 to 5 I will examine in detail the evidence presented by the three waves of financial reform – i.e. reform of securities, foreign exchange and banking respectively. While our primary interest is in overall outcomes, I will spend considerable time in the case study chapters teasing out the detail of the process of reform. In the belief that 'the devil lies in the detail,' we will attempt to gauge the extent to which the technocrat leadership approach accurately describes the timing and development of the three episodes of liberalization. Due attention will be given to other theoretical explanations where appropriate. Our burden of proof is in-keeping with the 'messy center'[83] of political science: Does our theory provide a better account of events than the alternatives?

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[82] Interview in Taipei with Mr. Paul Hsu, Senior Partner, Lee and Li Attorneys at Law, 15 July 1999.
[83] See symposium articles on the role of theory in comparative politics in *World Politics* Vol. 48, No. 1 (October 1995).

-Chapter 3-
The long march: securities reform through the 1980s and beyond

Introduction

In the years prior to 1988, when the Securities Exchange Law was finally amended, Taiwan's markets for equity and debt were regularly the subject of joke and scorn. Dismissed as a 'casino' by most foreign commentators,[1] the Taiwan Stock Exchange (TSE – *Taiwan Zhengquan Jiaoyisuo*) was simply a sideline in the investment decisions of the island's largest companies. As one market analyst remarked in an interview: 'The TSE was more a question of face for most companies; firms would seek to be listed largely as a means to gain public recognition. It was also a good way to reward employees: annual bonuses were often given in the form of equity which most employees would quickly place on the secondary market to convert into cash....'[2] Few people took Taiwan's securities markets seriously, least of all the government. The shabby building on Yen-ping South Road in Taipei that housed the stock exchange was more of an embarrassment for the local monetary authorities than a respected meeting place for representatives of the RoC's entrepreneurs and investors. But despite this official contempt, the story of securities reform in Taiwan holds a place which is no less important, or for that matter less intriguing, than liberalization of the island's banking industry or foreign exchange system. Indeed, according to some economists, domestic capital market reform is *the* linchpin of all other financial reform efforts. Serious studies first published in the mid 1980s, for example, argue that a lack of securities development can turn any other financial reform initiative into a second-best option.[3]

In the previous chapter of the thesis we examined the general character of the KMT regime and the policy elites who aspired to work within the ruling party. In the present chapter we are putting our theory of technocrat leadership to the test for the first time – one of three such case study chapters in this thesis. Our focus of inquiry starts with the process of securities reform that lasted from around 1980 to the early 1990s. This remarkably slow and incremental pattern of reform initially arose because the so-called 'development technocrats' – a loosely organized group of state officials lead by technology guru Li Kwoh-ting – choose to take up the liberalization agenda in the early 1980s and run with it. This much of the story is an historical tale of individual ideas and effort. However, the story of *when* and *how* Li's team of technocrats was able to act is part of a generalizable account of KMT preferences and strategies.

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1 See for example: Anthony Rowley, *Asian Stockmarkets: The Inside Story* (Hong Kong: Far Eastern Economic Review, 1987), chp. 4.

2 Interview in Taipei with John Pickles, Director of Research, Asian Pacific Research Ltd., Pacific Consulting Group, 24 April 1996.

3 Yoon Je Cho, 'Inefficiencies from Financial Liberalization in the Absence of Well-Functioning Equity Markets' in *Journal of Money, Credit and Banking* Vol. 18, No. 2 (May 1986).

In chapter 1 of the thesis I argued that for technocrats[4] to be ultimately successful with financial reform, two kinds of 'policy window' need to be open within their referent political party: a socio-political window generated by a reconfiguration of, or challenge to, the ruling political party's social support base; and a sectoral-strategy window created by any perceived failure of established financial policy to realize the party's sectoral goals.[5] In this chapter, I will demonstrate that the pattern of securities reform in Taiwan was long and measured because *these two policy windows opened almost eight years apart.* As we will see in later chapters of the thesis, this temporal spread of opportunities was radically different to reform efforts in the fields of foreign exchange administration or banking – a critical difference which explains the alternative processes of change experienced in those two areas.

The chapter is composed of four main parts. In part one we review in some depth the process of securities policy reform. I include an account of major steps in the reform cycle, and give due attention to institutional procedure so as to contextualize the raw regulatory data. In part two of the chapter we look behind the outcomes detailed in part one and commence our analysis of causal factors. This section includes an examination of the ideas and capabilities of the development technocrats, especially Li Kwoh-ting – the original 'policy hero' of the securities reform story. Part three of the chapter examines the policy windows that emerged within the KMT over the course of the 1980s. In this section we temporarily sidestep the role of the development technocrats in reform and examine why KMT policy windows opened in 1980 and 1987. Finally, part four of the chapter considers how the development technocrats capitalized on the KMT policy windows as they arose. This section includes an examination of the micro-politics of securities reform.

1. The process of securities reform

We saw in chapter 1 that Taiwan's shift in securities policy in the late 1980s was comprehensive and genuine, and similar in overall effect to reforms undertaken in the fields of foreign exchange and banking at around the same time. In terms of the way in which securities reform unfolded, however, the process of securities liberalization could not have been more different from the reform efforts undertaken in either of these other areas. In stark contrast to either forex or bank reform, the planning and execution of securities policy change was slow, methodical

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[4] From chapter 1: a technocrat is a state official who uses their claim to knowledge in some specialist area, or their ability to perform some specified function, to affirm their right to public office. See: Miguel A. Centeno and Particio Silva, 'The Politics of Expertise in Latin America: Introduction' in Miguel A. Centeno and Patricio Silva (eds.), *The Politics of Expertise in Latin America* (London: Macmillan Press, 1998), chp. 1. See also: Frank Fischer, *Technocracy and the Politics of Expertise* (Newbury Park: Sage Publications, 1990), chp. 1.

[5] A policy window is a political porthole or aperture through which entrepreneurial technocrats and their ideas can pass. The notion comes from: Jeffrey T. Checkel, *Ideas and International Political Change: Soviet/Russian Behavior and the End of the Cold War* (New Haven: Yale University Press, 1997), esp. chp. 1

and pursued in an incremental fashion. Indeed, it took almost as much time and effort to reform the regulatory structure of securities in Taiwan as it did to set it up in the first place.

TABLE 3.1 Process of securities policy reform, 1980 to early 1990s

Phase	*Period*	*Regulatory Initiative*
Takeoff	Apr 1980	Establishment of Fuh Hwa Securities Company.
	Jul 1981	SEC moved from MoEA to MoF.
	Late 1982	Plan to open TSE to foreign investment launched with SITEs.
Development	Early 1983	Committee review of SEL launched.
	Early 1984	Institute of Securities Market Development established.
	Aug 1985-	New emphasis on market safety enters reform equation.
	Dec 1985	Draft SEL submitted to EY.
	Aug 1986	EY backs Go-listed Campaign & Pre-listing Task Force.
	Feb 1987	EY approves draft SEL. Presented to LY.
Apex	Jan 1988	SEL passed by LY and new law promulgated.
Consolidation	May 1988	'Criteria for the Establishment of Securities Firms' issued.
	Dec 1990-	Foreign investment plan to 2nd & 3rd phase.
	Late 1991	Local SITEs permitted.

Notes: TSE is the Taiwan Stock Exchange, SEC is the Securities Exchange Commission, MoEA is the Ministry of Economic Affairs, MoF is the Ministry of Finance, SEL is the Securities Exchange Law, EY is the Executive Yuan, LY is the Legislative Yuan, and SITEs are securities investment trust enterprises. Sources: various, see especially: *SEC Annual Report* (Taipei: Securities Exchange Commission, Ministry of Finance, various issues), *TSE Fact Book* (Taipei: Taiwan Stock Exchange Corporation, various issues); and *Taiwan Zhengquan Shichang Ziyouhua yu Guojihua Yinying zhi Dao* [The Purpose and Process of Liberalization and Internationalization of Taiwan's Securities Markets] (Taipei: Zhonghua Minguo Zhengquan Shichang Fazhan Jijinhui, 1990), esp. chp. 1 & 3.

It is useful to see the historical process of securities liberalization in Taiwan as passing through four main phases of change (for a condensed catalogue, see Table 3.1).[6] These include the takeoff phase (1980-83), the development phase (1983-88), the apex of reform (January 1988), and the consolidation phase (1988-91 and beyond). The takeoff phase was a transitional period in which the regulatory authorities in Taiwan started to see securities liberalization as a serious policy option. Prior to 1980, securities regulation in Taiwan was a seesaw of market challenge and official crackdown in which wild gyrations in various legal and illegal securities markets were met with the introduction of progressively more restrictive laws and administrative standards. Historically, this balancing game had culminated in the passage of the Securities Exchange Law (SEL) of 1968. As we saw in chapter 1 of the thesis, the original SEL

[6] Interpreting policy change as a process of distinguishable phases is a well-established tradition in the political and policy sciences. See esp.: David Easton, *A Systems Analysis of Political Life* 2nd ed. (Chicago: University of Chicago Press, 1979); and Brian W. Hogwood and Lewis A. Gunn, *Policy Analysis for the Real World* (Oxford: Oxford University Press, 1984). I use the model purely as a heuristic ordering device and make no claim for its theoretical merit.

was an illiberal document that rendered the issuance and trading of securities in Taiwan a highly exclusive practice. Despite the semblance of development that the introduction of this legal framework symbolized, it placed a tight cap on securatization in the RoC. Over the 1970s, the authorities occasionally tinkered with the SEL, however, no major change was ever seriously contemplated.[7]

In the three years from 1980 to 1983, official thinking gradually congealed around the idea that the regulatory framework for securities had to change. This adjustment in outlook was marked by three discontinuous reform moves. The first sign of a break with the past came in April 1980 with the establishment of the Fuh Hwa Securities Finance Company (*Fuhua Zhengquan Jinrong Gongsi*). Fuh Hwa was introduced as part of an overhaul of margin transactions on the local bourse. The old restrictive arrangement with the state-owned banks was replaced with a system which made licensed brokers commissioned agents of Fuh Hwa – a move which legitimated illegal broker assisted stock purchases and preempted a dramatic increase of margin financing.[8] The flurry of activity that surrounded the introduction of Fuh-Hwa was followed by more than 12 months of inactivity. In July 1981, however, the Executive Yuan transferred the Securities Exchange Commission (SEC) from the control of the Ministry of Economic Affairs (MoEA) to the Ministry of Finance (MoF). While no specific reason was given for the initiative, most observers believed that it was a prelude to a comprehensive overhaul of the securities sector. Finance commentators reasoned that the Ministry of Finance, with its oversight responsibilities for RoC financial institutions, was a more appropriate base for planning the expansion of securities finance.[9] And finally, in late 1982, a staggered opening of the TSE to foreign investment was announced. In the first step of a three stage process of liberalizing the market,[10] four 'securities investment trust enterprises' (SITEs – *zhengquan touzi xintuo gongsi*) were to be established to issue beneficiary certificates abroad and invest in the local stock exchange. These mutual funds would be managed by foreigners but retain majority local ownership.[11]

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[7] For a review of these early developments, see: Antoine W. van Agtmael, *Emerging Securities Markets: Investment Banking Opportunities in the Developing World* (London: Euromoney Publications, 1984), p. 88; and *Securities Markets in Asia and Oceania*, 2nd ed. (Tokyo: Asian Securities Analysts Council, 1988), p. 515.

[8] See: *Fuhua Zhengquan Jinrong Youxian Gongsi, 84 Niandu* [Fuh Hwa Securities Finance Company, Ltd. Annual Report 1995] (Taipei: Fuh Hwa Securities Finance Company, 1995), p. 9; *Far Eastern Economic Review* (5 December 1980), p. 117-118; and *RoC Securities Market Annual, 1992* (Taipei: Institute of Securities and Futures Markets Development, 1992), p. 79.

[9] *RoC Securities Market Annual, 1993* (Taipei: Institute of Securities and Futures Markets Development, 1993), p. 68; *Far Eastern Economic Review* (28 August 1981), p. 87; and *Far Eastern Economic Review* (20 November 1981), p. 84.

[10] Under the plan, local securities markets were to be opened in the following order: first to foreign mutual funds, second to foreign institutional investors, and third to individual foreign citizens. For details, see: *Introduction to the Taiwan Stock Exchange Corporation* (Taipei: Taiwan Stock Exchange Corporation, 1993), p. 18-19.

[11] The preparatory work involved in this cautious policy shift dragged into late 1983, and in November the now famous 'Taiwan RoC Fund' was launched under the management of the International Investment Trust Company. As stage one of the liberalization plan commenced, no specific timetable for the implementation of stages two and three was given. King Pu, 'Prospects are Bright for Foreign Investment

In the development phase of securities reform (1983-88) the regulatory authorities in Taiwan gradually constructed a cohesive strategy for change. Just as the takeoff phase of reform had been protracted and discontinuous, so too was this second stage, however the development phase was marked by a heightened sense of purpose. In early 1983, after receiving the go-ahead from the Executive Yuan, the Ministry of Finance and the Securities Exchange Commission invited a number of scholars and finance practitioners to conduct workshops on improving the Securities Exchange Law. It was hoped that the outcome of the workshops would be a comprehensive rewrite of the existing legal framework.[12] The committee review process proceeded in a staggered manner over the next three years, taking on board new players and incorporating new interests along the way. In the second half of 1983 the general upsurge in the economy and the stock exchange generated demands among Taiwan's small collection of brokers for an increase in commission fees.[13] Seizing the opportunity to link this lobby effort to the reform agenda, the Securities Exchange Commission tied increases in brokers' commissions to the creation of a new industry association, funded by mandatory broker contributions. The Institute of Securities Market Development (*Zhengquan Shichang Fazhan Jijinhui*) opened its doors in early 1984 and became actively involved in the on-going review of the SEL.[14] However, the boom conditions that had emboldened local brokers came to an abrupt end in early 1985. The 10th Credit Cooperative scandal (an event which we will examine in more depth in chapter 5) placed the question of market safety on the agenda. Stronger penalties for insider trading and market manipulation were included in the evolving draft of the SEL, as were greater policing powers for the Securities Exchange Commission. Dovetailing with these legal provisions, a program to computerize TSE trading was launched in August 1985 (and concluded in May 1987).[15]

While computer assisted trading was being introduced, a final draft of the new Securities Exchange Law was produced. After nearly three years of committee work, the Ministry of

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in the Local Stock Market' in *Financial & Investment Yearbook, RoC 1983-84* (Taipei: China Economic News Service, 1984); and *Far Eastern Economic Review* (20 October 1983), p. 13.

[12] The topics broached within these hearings covered the full spectrum of potential securities market reform. Official aims included: (1) improving Taiwan's primary markets for stocks and bonds so that they may be utilized more effectively as a means for companies to raise funds, (2) improving the secondary markets so that they may become a more desirable avenue for individual and corporate investment, and (3) raising the quality of service provided by companies in the securities industry to increase general market participation by both investors and issuing companies. See: *RoC Securities Market Annual, 1993*, fn. 9, p. 69.

[13] *Far Eastern Economic Review* (22 March 1984), p. 63-64.

[14] Interview in Taipei with Dr Chung-hsing Chen, President, Institute of Securities and Futures Markets Development, 30 August 1996. The Institute of Securities Market Development was renamed the Institute of Securities and Futures Markets Development in 1992 with the introduction of the Foreign Futures Trading Law. Information on its current activities can be found at http://www.sfi.org.tw/newsfi/ [home page of the Institute of Securities and Futures Markets Development] – viewed on 2 September 2000.

[15] Claire Chen, 'Only a Healthy Market Can Guarantee Progress: Interview with Shen Pe-ling, Chairman of the Securities Exchange Commission' in *Financial and Investment Yearbook, RoC 1987* (Taipei: China Economic News Service, 1987), p. 107. For information on the computerization of the TSE, see: *Taiwan*

Finance submitted the amended law to the Executive Yuan for approval in December 1985. For much of the following year, the Executive Yuan held the document in abeyance while the stock market and the wider economy began to experience a dramatic upturn.[16] However, as a signal that the government had not lost sight of the reform agenda, in August 1986 the Executive Yuan issued a call for more companies to list on the stock market.[17] Immediately after this edict, the Securities Exchange Commission launched the so-called 'Go-listed Campaign' and established the 'Pre-listing Orientation Task Force.'[18] Several months later (5 February 1987) the Executive Yuan approved the draft Securities Exchange Law. Cabinet revisions had been minimal, and it was now up to the Legislative Yuan to decide the fate of securities reform in Taiwan.[19] Upon reaching the Legislative Yuan, passage of the new law became politicized, leading to one final addition to the document. The freeze on brokerage licenses became a major issue of contention between the Executive Yuan and the legislators, tying-up passage of the statute for the next 12 months. The Executive Yuan resisted the Legislative Yuan's requests to grant new licenses, and legislators responded by refusing to vote on the new securities law. Eventually Cabinet adopted a carrot and stick strategy: it gave ground on the license question, but threatened an investigation of business activities on the TSE. As a number of legislators were major players in the stock market, the Legislative Yuan soon moved to ratify the bill.[20] The amended Securities Exchange Law was finally passed on 12 January 1988 and promulgated almost immediately thereafter.

The passage of the new Securities Exchange Law heralded the apex of securities reform in Taiwan and, as shown in chapter 1, foreshadowed the beginning of a more open, more inclusive securities sector. The final document contained less than the early reform workshops had hoped for due to legal restrictions on the extent of permissible amendment.[21] It was also a slightly different animal to the law originally envisaged: various changes along the way had added new

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Zhengquan Jiaoyisuo, 76 Niandu Nianbao [Taiwan Stock Exchange Corporation Annual Report 1987] (Taipei: Taiwan Stock Exchange Corporation, 1987), p. 22.

[16] For an overview of the wacky economics of the TSE during this period, see: Jih-chu Lee, 'Taiwan Gupiao Shichang Chigu Xingwei zhi Shizheng Yanjiu' [An Empirical Study of Stock Holding Behavior in the Taiwan Stock Market: 1986-90] in *Journal of Financial Studies* Vol. 2, No. 2 (January 1995).

[17] *SEC Annual Report, 1986* (Taipei: Security and Exchange Commission, Ministry of Finance, 1987), p. 83.

[18] The 'Go-listed Campaign' called for a doubling of listed companies in five years. The 'Pre-listing Orientation Task Force' was an incubator-style resource to provide advice and support to potential listees. See: *Taiwan Zhengquan Jiaoyisuo, 77 Niandu Nianbao* [Taiwan Stock Exchange Corporation Annual Report 1988] (Taipei: Taiwan Stock Exchange Corporation, 1988), p. 17.

[19] See: *Taiwan Zhengquan Jiaoyisuo, 76 Niandu Nianbao* [Taiwan Stock Exchange Corporation Annual Report 1987], fn. 15, p. 38.

[20] Details of these events are recorded in: Mark Tung, 'Stock Brokerage Houses: Time to Lift the License Ban' in *Financial and Investment Yearbook, RoC 1988* (Taipei: China Economic News Service, 1988), p. 118; and Claire Chen, 'Boom, Bust and Recovery: A Year to Remember, or Forget' in *Financial and Investment Yearbook, RoC 1988* (Taipei: China Economic News Service, 1988), p. 108. See also: *Zhongguo Shibao* [China Times] (16 September 1987), p. 2.

[21] 'The reforms that were made to the SEL represented no more than one third of the total document as changes in excess of this proportion require the development and passage of a new law. The 1988 changes were, therefore, only a portion of what we wanted to achieve.' Interview in Taipei with Dr Chung-hsing Chen, President, Institute of Securities and Futures Markets Development, 30 August 1996.

issues and new players to the text of the document. In the end, however, the proposed changes encompassed more than one third of the original Securities Exchange Law, or some 60 new articles. Upon receipt of the revised law, the Securities Exchange Commission outlined the eight key areas of reform. These included new provisions for: company disclosure, auditing, issuance of stocks and bonds (together with a range of new instruments), margin transactions, illegal transactions, insider trading, punishment of securities-related offences, and securities underwriting, dealing and trading.[22] In total, these changes represented a radical break with the past. After nearly five years in development, and a further three years prior to that surveying the options, Taiwan could finally claim to be taking the issue of securities reform seriously.

In the consolidation phase of the reform process, the regulatory authorities in Taiwan gradually moved to strengthen and secure the new regime. In early May 1988 the Securities Exchange Commission promulgated the Criteria for the Establishment of Securities Firms and began accepting applications for new securities company licenses.[23] By the end of 1989 there were more brokers in Taiwan than companies listed on the stock exchange – 373 licensed brokers and 41 integrated securities houses.[24] Thereafter, the collapse of the stock market in February 1990 saw nearly 100 securities firms close their doors; the fledgling securities business would face hard times well into the middle of the 1990s. As the decade progressed, however, lackluster activity in local markets occasioned a series of follow-up reforms. These episodes of regulatory change were the logical conclusion of the reform process started more than a decade before with the introduction of the Fuh Hwa Securities Finance Company. In December 1990, for example, the government sought to expedite plans to allow foreign portfolio investment in local markets. The Executive Yuan promulgated an amended version of the Regulations Governing Securities Investment by Overseas Chinese and Foreign Investors, and in the new year the Securities Exchange Commission began accepting applications from foreign institutional investors. With these players firmly established in local markets by the middle of the decade, individual foreigners were also given access.[25] A similar story can be told for mutual funds. In late 1991, the Securities Exchange Commission sought to expand the role of the securities investment and trust enterprises in the local market. After receiving permission from the Executive Yuan, the Commission started accepting applications for the establishment of domestic enterprises. In January 1992 the Securities Commission nominally approved the entry of 11 new enterprises, all owned and operated by local consortiums.[26]

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[22] From: *Zhongguo Shibao* [China Times] (13 January 1988), p. 1.
[23] *Gongshang Shibao* [Commercial Times] (3 May 1988), p. 17; and *Gongshang Shibao* [Commercial Times] (6 May 1988), p. 16.
[24] For details see: *TSE Fact Book, 1990* (Taipei: Taiwan Stock Exchange Corporation, 1991), p. 55.
[25] See: Peter Harmsen, 'Foreign Funds to Change Taiex' in *China Post* (5 August 1996), p. 12.
[26] See: Danny Chan, '1992 Exposed: The Stockmarket's Hidden Structural Problems' in *Financial and Investment Yearbook, RoC 1993* (Taipei: China Economic News Service, 1993), p. 65-66.

2. The development technocrats and the rationale for change

The account of securities reform in Taiwan given above confirms that the process of policy change was remarkably slow and incremental. While the final passage of the new Securities Exchange Law in early 1988 was somewhat more significant than other steps in the process, the sequence of four phases took more than a decade to complete and comprised no sharp, unexpected climax. This course of policy adjustment stands in sharp contrast to the remaining episodes of financial reform. As we shall see in the next chapter, for example, the liberalization of the foreign exchange system covered a period of just three to four years, and was pursued in an urgent and energetic manner. There is, therefore, nothing intrinsic to Taiwan that implied that securities opening on the island had to be slow and incremental. Further, there is nothing intrinsic to securities administration *per se* that suggests reform in Taiwan had to follow this pattern. In countries such as the United Kingdom and France (countries with financial systems substantially more complex than Taiwan's), securities reform was pushed through with all the Taylorite efficiency of an industrial assembly line.[27] Compared with these expeditious examples, securities liberalization in Taiwan was not so much a big bang as a protracted whimper.

So what explains the process of securities reform in Taiwan? To be sure, *aspects* of the reform process can be explained with the standard theoretical tools we reviewed earlier in the study.[28] This being said, the established theoretical approaches all fail dismally in explaining why the overall pattern of securities reform was slow-paced rather than a sharp spike of activity. They are particularly poor in explaining why the combined period for the takeoff and development phases of securities reform totaled nearly eight years, and simply 'melded' into the apex of reform with seamless continuity. Indeed, when the amended Securities Exchange Law was finally passed in 1988, the reform process had been going on so long that the introduction of the new regulatory framework appeared inevitable and therefore unspectacular.[29] It is a broad theme of this study that liberalization of financial regulation occurs because of 'technocrat leadership.' Reform first arises as a conceptual strategy because well-positioned

[27] As recorded respectively in: Steven K. Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries* (Ithaca: Cornell University Press, 1996), chp. 5; and Jacques Melitz, 'Financial Deregulation in France' in *European Economic Review* Vol. 34 (1990).

[28] The theories include: the market-driven approach, statist analysis, pluralism and the foreign pressures model. See chapter 1, part two. Leading examples of these four theories include respectively: Richard O'Brien, *Global Financial Integration: The End of Geography* (London: Pinter Publishers, 1992); Louis W. Pauly, *Opening Financial Markets: Banking Politics on the Pacific Rim* (Ithaca: Cornell University Press, 1988); Frances McCall Rosenbluth, *Financial Politics in Contemporary Japan* (Ithaca: Cornell University Press, 1989); and Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca: Cornell University Press, 1994).

[29] Newspaper articles in Taiwan regarding the passage of the amended SEL were inclined to be simple information reports (of the this-is-what's-happened variety) rather than analyses of the implications of the new legal framework. There were no editorials on the topic, no lead-up stories, and front-page coverage was only attained in most major newspapers on the single day after the event. It is fairly obvious from reading the few available reports that by 1988, the press in Taiwan saw securities reform as an old issue. See for example: *Zhongguo Shibao* [China Times] (13 January 1988), p. 1; and *Jingji Ribao* [Economic

public officials decide to take up the reform agenda and run with it. We will see below that the development of the securities reform agenda owed much to the ideas and effort of the 'development technocrats' – a loosely bound group of officials that counted among their number technology guru Li Kwoh-ting. These individuals were motivated by a belief that technological upgrading in Taiwan was strongly dependent on the development of more mature capital markets on the island. This thinking had gelled into a cohesive strategy as the 1980s opened, and was subject to refinement and revision as the decade progressed.

But while the origin of securities reform is a tale of technocrat ideas and effort, the story of when and how these individuals were able to act is a study in KMT politics. In chapter 1 of the thesis I argued that for technocrats to be ultimately successful with financial reform, two kinds of 'policy window' need to be open within their referent political party: a broad socio-political window and a narrow sectoral-strategy window. I argue below that the pattern of securities reform in Taiwan followed the course detailed in part one of this chapter because insofar as this sub-sector of finance was concerned, *these two windows of opportunity opened almost eight years apart.* In a manner that compares starkly with forex reform and to a significant extent with bank liberalization, the temporal spread of party political opportunities that faced the likes of Li Kwoh-ting was wide and discontinuous. The development technocrat's reform agenda got off the ground in 1980 because it was seen as an effective means of securing middle class support for the KMT in the face of growing competition from the opposition *dangwai* (socio-political window opens). Reform reached its apex and moved to the consolidation phase after 1987 because the systemic character of local securities markets at that time radically breached the ruling party's preference for a stable and controllable financial system (sectoral-strategy window opens). The amount of time involved between these two windows meant that the development technocrats had no other choice but to make securities liberalization a measured and methodical exercise.

The development technocrats[30] were distinguishable as a group by their exclusive interest in the growth and structural upgrading of Taiwan's real economy. For them, the object of economic policy in general and financial policy in particular was to improve the basic conditions of production in tradable and non-tradable goods. Although they differed widely on policy prescriptions, they were united in seeing Taiwan's central economic task as industrial catch-up – first with Japan and then economies outside the region.[31] The role of the financial

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Daily News] (13 January 1988). The contrast with newspaper and magazine coverage of the banking and forex reform episodes could not be more pronounced.

[30] As noted in chapter 1 of the study, the development technocrats were a latter-day version of the 'industrializing reformers' – a group that had been influential during the shift to export oriented industrialization in the early 1960s. See: Stephan Haggard and Chien-kuo Pang, 'The Transition to Export-Led Growth in Taiwan' in Joel D. Aberbach, David Dollar and Kenneth L. Sokoloff (eds.), *The Role of the State in Taiwan's Development* (Armonk: M.E. Sharpe, 1994), p. 68-69.

[31] Elements of the 'flying geese' theory of industrialization are apparent here. See esp.: Bruce Cummings, 'The Origins and Development of the Northeast Asian Political Economy: Industrial Sector, Product Cycles and Political Consequences' in *International Organization* Vol. 38, No. 1 (Winter 1984).

sector (and the service industry more broadly) in this process was subordinate, and revolved around one key goal: sustaining investment in progressively more sophisticated manufacturing. By the end of the 1970s, the development technocrats had acquired a spiritual mentor in technology expert and seasoned economics administrator Li Kwoh-ting (*Li Guo-ding*), and were occasionally referred to as the 'KT Faction' (*KT Pai*).[32] While similar to the rest of Taiwan's senior technocrats in their level of competence, relationship to the KMT regime and overall outlook (see arguments in chapter 2, section three), they differed from other technocrats in several important ways. They were usually distinguishable as officials with: (1) an academic background in science, law, humanities or engineering, but rarely economics and almost never finance economics; (2) extended experience in the Ministry of Economic Affairs or the Ministry of Finance, but rarely the Central Bank of China or the economic commissions of the Executive Yuan; and (3) experience as a manager in one of Taiwan's state-owned enterprises, typically those with large economies of scale such as China Steel (*Zhong Gang*) but only rarely the state-owned banks. In a manner that seems to have eluded the other policy elites covered in this study, a small number of the development technocrats managed to acquire a high level of public respect and admiration in Taiwan. They were held in high regard for their ability to link economic progress with nationalist sentiment, their disregard for the personal costs associated with holding office, and their understanding of the need to be inclusive when pursuing policy change. There are parallels here with Arnold Harberger's 'policy heroes,' although Harberger would have been uncomfortable with the sympathy for economic planning exhibited by some members of the group.[33]

Beyond these broad similarities in policy outlook and career paths, the development technocrats were a diverse and fragmented group encompassing elites with a notable dirigiste bent as well as those with a far more liberal approach to economic management. Among those with statist leanings – aside from Li Kwoh-ting himself – we can count the likes of Chao Yao-tung, Y.S. Sun and Lee Ta-hai. Occasionally these individuals and their immediate followers were called the *qiangguo pai* (the strong country faction), although by the mid to late 1980s this title had begun to sound a little passé and was less and less relevant to the policy agenda they advanced.[34] Among the development technocrats with less faith in the efficacy of state intervention we can include Hsu Li-teh (more on him below), Loh Jen-kang, Wang Chou-ming and quite a few younger officials, including such aspirants as Patrick Pai, Shen Pe-ling and C.P.

Debate on the accuracy of Cuming's product cycle hypothesis has attracted some interesting research on regional development in Pacific Asia. See for example: Mitchell Bernard and John Ravenhill, 'Beyond Product Cycles and Flying Geese: Regionalization, Hierarchy and the Industrialization of East Asia' in *World Politics* Vol. 47, No. 2 (January 1995).

[32] Jun Wang, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [Finance Master: Yu Kuo-hwa's Life and Travels] (Taipei: Sunbright Publishing Company, 1999), p. 248.

[33] Arnold C. Harberger, 'Secrets of Success: A Handful of Heroes' in *The American Economic Review* Vol. 83, No. 2 (May, 1993).

[34] See: *Tianxia Zazhi* [Commonwealth Magazine] (1 June 1986), p. 12-20.

Chang.[35] For many of these latter individuals, association with the development technocrats was probably as much a question of strategic identification as a matter of policy preference. With little or no economic training and none of the social network ties that defined other factions within Taiwan's technocracy (more in the following chapters), association with the development technocrats was in large measure a default position. Reflecting the development technocrats' diverse constitution, the group maintained an eclectic mix of relationships with Taiwan's academic community. Occasionally they sought the advice of high profile neo-classical economists such as Liu Ta-chung, Tsiang Sho-chieh and John Fei, while at other times, economists with near-structuralist leanings like Wang Tso-jung were invited into the circle.[36] By and large, there was little formal pattern in the character of these links, and nothing that approached the form of a permanent institutional connection.

The leading light of the development technocrats and the man singularly most responsible for securities reform in Taiwan was the charismatic Li Kwoh-ting. Li was a Renaissance man with interests and capabilities in an incredibly wide range of areas. His academic interests stretched from theoretical science and civil engineering on the one hand, to development economics and social ethics on the other. Although his only formal qualification was an undergraduate science degree attained on the mainland in the 1920s, at various times Li held research and teaching positions at Cambridge University, King's College in London, the Chinese University of Hong Kong, New York State University, Sung Kyun Kwan University in South Korea, National Taiwan University and many others. Over his career, he was granted more than half a dozen honorary degrees, including a Doctor of Science from National Chengchi University in Taipei (awarded in 1983), a Ph.D. in engineering from National Chiao Tung University in Hsinchu (1989) and a Doctor of Laws from Boston University (1991).[37] Li's employment history was typical for a member of the development technocrats. Before being promoted to the position of Minister of Economic Affairs in 1965, Li held senior positions in the Taiwan Shipbuilding Corporation (a state-owned enterprise), the Industrial Development Commission, the Council for United States Aid and the Council for International Economic Cooperation and Development. After serving for four years as Minister of Economic Affairs (1965-69), he was appointed to the position of Minister of Finance, a post he held till 1976. In subsequent years, Li ascended to the murky heights of the KMT policy machinery, taking up a

[35] See personal interviews with these individuals in: *Financial & Investment Yearbook, RoC* (Taipei: China Economic News Service, various issues, 1980s).

[36] The ideological gulf between these two groups should not be exaggerated, but it remained a significant feature of the economics profession through the late 1980s. See John Fei's elaboration of the key disagreements between himself and Wang Tso-jung in: John C.H. Fei, 'Wang Zuo-rong Xiansheng he Wo de Shier Da Guannian Tuili' [An Examination of the Twelve Ideological Differences Between Mr Wang Tso-jung and Myself] in *Lianhe Yuekan* [United Monthly] Vol. 14 (1982). For an interesting article on the influence of structuralism in Taiwan (and its ultimate rejection by policy makers) see: Chi-ming Hou, 'The Structuralists, the Neoclassicists and Industrial Upgrading in the Republic of China' in *Industry of Free China* Vol. 63, No. 2 (February 1985).

[37] From: *Republic of China Yearbook, 1996* (Taipei: Government Information Office, 1996), p. 516.

position as Minister of State on the Executive Yuan *(Xingzhengyuan Zhengwu Weiyuan)*.[38] Retaining this position until the late 1980s, Li concurrently held posts on the Central Advisory Committee of the KMT, the Council for Economic Planning and Development and seemingly countless other consultative committees and boards.[39]

Apart from senior statesman Li Kwoh-ting, it is difficult to point to any other key player within the development technocrats who had sustained involvement in securities opening (it will be remembered that the securities reform process covered more than a decade – we might expect individuals to come and go over this timeframe). While the development technocrats *as a group* were the driving force behind the overall securities reform story, the actual 'policy heroes' among them were few in number. This being said, one other player is certainly worthy of mention up front: the enigmatic Hsu Li-teh (*Xu Li-de*). The historical record of Hsu Li-teh's contribution to financial reform in Taiwan has been sadly obscured by the 10th Credit Cooperative scandal of 1985, an event that Hsu had the misfortune to be strongly connected with. This incident cost Hsu his job as Minister of Economic Affairs in March of that year, and cast a black cloud over his time as Minister of Finance in the early years of the decade.[40] To this day, it is not clear whether the 10th Credit Cooperative scandal had any direct link to Hsu *per se* – he resigned taking 'moral responsibility' for the incident – or was simply a case of guilt by association.[41] Either way, Hsu never fully recovered the public's trust over the matter, and failed to receive due recognition for his exceptional administrative work in the first half of the 1980s.

In both thought and deed, Hsu Li-teh was a generalist civil servant driven by a sincere desire to serve the nation. Academically, Hsu saw the world through the eyes of an administrative analyst. In the late 1950s, he completed a Bachelor of Laws in public administration at the Taiwan Provincial College of Law and Commerce, and thereafter attained a Masters in Law at National Chengchi University. During a period of academic work in the 1960s he produced a number of publications on public sector management.[42] Some years later in his career, Hsu undertook an MPA at Harvard, and wrote prolifically on topics as diverse as

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[38] *Zhengwu Weiyuan* is often translated as 'Minister Without Portfolio,' a title that in my view demeans the respect and seniority associated with the Chinese term. Unless otherwise noted, I substitute the phrase Minister of State for Minister Without Portfolio.

[39] *Zhonghua Minguo Mingrenlu, Minguo 88 Nian* [Who's Who in the Republic of China, 1999] (Taipei: Central News Agency, 1999), p. 57.

[40] *Far Eastern Economic Review* (21 March 1985), p. 150-153.

[41] I am inclined to believe the latter. On more than one occasion, Hsu demonstrated poor judgment and bad timing. In a typical example, the defeat of Kuomintang candidate Lien Chan in the 2000 presidential election saw Hsu dragged from his car and beaten by an angry mob of Nationalist Party supporters. Whatever was he doing there?! See headline story from *Taipei Times* (20 March 2000) at http://www.taipeitimes.com/news/2000/03/20/story/0000028484/ – viewed on 9 September 2000.

[42] Some of these publications became standard reference texts in public administration courses at RoC universities. See in particular: Li-teh Hsu, *Renyuan Guanxi yu Guanli* 3rd ed. [Personnel Relations and Management] (Taipei: Zhonghua Qiye Guanli Fazhan Zhongxin, 1985); and Li-teh Hsu et.al., *Ruhe Zuo Lianghao de Zhuguan* [How to Be a Good Director] (Taipei: Zhongguo Gonggong Xingzheng Chuban, 1964).

financial policy and development, consumer protection and the distribution of income.[43] While Hsu was not drawn toward finance in the academic world, his career path through the RoC state and ruling party certainly prepared him for high-level work in that area. After four years working as a senior official in the Executive Yuan (where Hsu first met and befriended the elder Li Kwoh-ting), in 1976 Hsu was recruited to the position of Administrative Vice Minister in the Ministry of Finance. He held this position for just two years before being made Commissioner of the Department of Finance in the Taiwan Provincial Government. Having proved his metal in that job, Hsu then took up the Finance Minister's position in 1981 and stayed there till 1984, when he was made Minister of Economic Affairs. Interrupted by the 10th Credit Cooperative scandal in 1985, Hsu's hitherto spectacular career then underwent a brief hiatus before being 'restored' toward the end of the decade. After that, he held numerous positions inside the government and ruling party, including chair of the Central Finance Committee of the KMT, Vice Premier of the Executive Yuan, chair of the Council for Planning and Economic Development and member of the KMT Central Standing Committee.[44]

As some of the more dirigiste policy makers among Taiwan's technocracy, the development technocrats may seem an unlikely group to have played a starring role in the process of securities reform. Indeed, Li Kwoh-ting, as a long-time advocate of economic planning,[45] only ever publicly addressed the issue of financial policy opening on a handful of occasions over the 1980s.[46] This said, the broader program for industrial development advanced by Li directly implied that the shackles on securities issuance and trading – shackles Li himself had helped put in place during the 1960s while he was Minister of Economic Affairs – had to come off. Over the decade of the 1970s, the development technocrats gradually constructed a rounded and coherent vision of the nation's industrial future. They believed that the days when Taiwan could rely on low value-added manufacturing (clothing and textiles, toys, household electrical

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[43] For these topics, see respectively: Li-teh Hsu, *Jinrong Shichang de Fazhan yu Fawang* [Development and Prospects of the Financial Markets] (Taipei: Wenhua Chuban Zhongxin, 1994); Li-teh Hsu, *Xiaofeizhe Baohu Linian yu Fawang* [Consumer Protection: Concepts and Prospects] (Taipei: Xingzhengyuan Xiaofezhe Baohu Weiyuanhui, 1997); and Li-teh Hsu, *Pingdeng yu Xiaolu* [Equity and Efficiency] (Taipei: Guanta Chuban, 1989).

[44] For a brief English overview, see CV material: 'New Members of the Cabinet, Vice Premier, RoC, Mr Hsu Li-teh' at http://park.org/Taiwan/Government/Events/June_Event/html/2e.html – viewed on 9 September 2000.

[45] See esp.: Kwoh-ting Li and Wan-an Yeh, 'Economic Planning in the Republic of China' in Kwoh-ting Li and Tsong-shian Yu (eds.), *Experiences and Lessons of Economic Development in Taiwan* (Taipei: Institute of Economics, Academia Sinica, 1982).

[46] After the 1980s, however, Li wrote extensively on the topic. The content of these later publications demonstrate that while publicly Li gave the issue of financial reform an analytical backseat, he was fully aware of its importance and repercussions. Looking back in 1995, Li wrote: 'Before the 1970s, the government employed strict regulations and administrative directives to ensure that limited resources were allocated in line with its development strategy and thereby achieve national goals. And the results were very encouraging. As the level of economic development got closer to the developed one [sic.], however, such an interventionist approach seemed less successful in accelerating the pace of development, but even squandered the economic potential. Therefore, when several factors promoted financial reform during the 1980s, the government took steps to liberalize its financial system.' Kuo-ting Li, *The Evolution of Policy Behind Taiwan's Development Success* 2nd ed. (Singapore: World Scientific Publishing Company, 1995), p. 124.

appliances, etc.) to deliver the high export and high growth figures of the 1960s and early 1970s were fast drawing to a conclusion. Pointing to Taiwan's rising cost structure, Li and others argued that the island had to make a conscious leap into the world of high-tech manufacturing, or run the risk of increasingly sluggish economic performance.[47] By 1980, this message had become a refined marketing slogan that the development technocrats sold to just about anyone who would listen. In his capacity as senior minister, Li Kwoh-ting gave literally hundreds of guest speeches outlining his plans for Taiwan's emergence as a leading international supplier of cutting-edge manufactures, including computers and electronics, biotechnology and pharmaceutical products, machine tools and advanced composite materials, among many others.[48]

This development agenda not only implied a need for new types of companies in Taiwan and a concerted national push on research and development (R&D) and higher education,[49] it also implied that the RoC develop a radically different financial system. Firms producing technology intensive products requiring long lead times, often with large economies of scale, have complex and variable financial needs. Typically, innovative companies will pass through four stages of enterprise development utilizing four different kinds of financial service: (1) the start-up phase, where innovative firms require venture capital support, (2) the growth phase, where they need so-called 'mezzanine financing,' usually through a limited dispersal of firm equity, (3) the consolidation phase, where they seek to have securities publicly dispersed and traded, and (4) the diversification stage, where they utilize the funds of standard financial intermediaries such as banks.[50] At the start of the 1980s, Taiwan only possessed institutional facilities that could provide financial services at the fourth stage in the lifecycle of a technology intensive enterprise. Services relevant to the first three stages were either extremely poor or non-existent. While it is conceivable that direct government intervention could partially substitute for a venture capital industry, financing in the growth and consolidation phases of a high-tech firm's development would need well-functioning primary and secondary markets for debt and equity. All things being equal, Taiwan's leap into the world of high-tech

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[47] Initially, Li's call for high-tech industrial upgrading was also tied to a call for 'backward integration' – i.e. more heavy industry, especially petrochemicals and metal processing. It is very conspicuous in Li Kwoh-ting's writing that this associated agenda was dropped at the start of the 1980s. It is possible that the second oil shock had encouraged Li to reconsider his plans. See esp. the latter chapters of: Lu-dao Kang, *Li Guo-ding Koushu Lishi, Huashuo Taiwan Jingyan* [Li Kwoh-ting's Oral History of the Taiwan Experience] (Taipei: Zhuoyue Publishing, 1993), esp. 10-12.

[48] Kwoh-ting Li, *Economic Transformation of Taiwan, RoC* (London: Shepheard-Walwyn Publishers, 1988), sect. 4, chp. 20-28.

[49] See for example: Kwoh-ting Li, 'New Business Concepts for the Dynamic 80s' in *Industry of Free China* Vol. 56, No. 2 (August 1981).

[50] For this process model of high-tech firm development and financial services, I am indebted to comments made by Mr Paul Hsu. Interview in Taipei with Mr Paul Hsu, Senior Partner, Lee and Li Attorneys at Law, 15 July 1999. For more information on the link between high-tech enterprises and securities markets in the Taiwan context, see: Kuo-shu Liang and Jin-ying Hou, 'Wo Guo Jinrong Zhidu yu Jinrong Zhengce' [RoC Financial System and Financial Policy] in *Ziyou Zhongguo zhi Gongye* [Industry of Free China] Vol. 61, No. 4 (April 1984); and An-ye Lin and Shi-wan Sun, *Ruhe Xiezhu Wo*

manufacturing required a new securities sector. The development technocrats' industrial policy agenda had inadvertently created urgent demand for securities reform.

But implied demand did not instantaneously equate to a comprehensive plan for securities policy change. It took time for the implications of the development technocrats' industrial agenda to become apparent. Publicly at least, Li Kwoh-ting himself was not at the forefront of this process of 'lateral' policy innovation, but other development technocrats certainly were, most notably Hsu Li-teh.[51] In ideational terms, the main contribution of Hsu and those close to him was to put flesh on the development technocrat's implied securities reform agenda – to describe what securities reform would actually look like and where it would fit in with other areas of RoC economic policy. In the opening years of the 1980s, Hsu and others were making strident calls for improving the '...financial system so that it can better support the growth and development of [the RoC] economy.'[52] Though he conceded Taiwan had the basic institutions of a modern securities sector (a stock market, a securities commission, a network of brokers, dealers and underwriters, etc.), Hsu saw these as wholly inadequate to the task of supporting industrial upgrading. He called for a radical overhaul of the existing framework: 'We need more and better support systems and institutions, including a better defined legal framework for securities, better accounting standards and procedures, and more qualified CPAs, financial analysts, brokers, dealers and underwriters. In short, we need a whole new system of institutions and a variety of professionals to serve the needs of our capital market.'[53] For Hsu and other development technocrats, the introduction of a new framework for securities issuance and trading was a central piece in a larger policy puzzle. The other pieces of this puzzle included comprehensive tax reform, a redefinition of the role of state-owned enterprises in the economy (including widespread privatization), and a total rethink of the conduct of monetary and fiscal policy on Taiwan. These pieces would gradually come together over the course of the 1980s, forming a unified whole in which expanded private investment would gradually replace a shrinking government sector. Sometime in the 1990s, Taiwan would emerge as an advanced industrial economy with a finite role for government in the development process – a vision that, in a number of fundamental ways, was ultimately realized.[54]

Guo Gao Keji Gongsi Shangshi Shanggui zhi Yanjiu [A Study of the Ways of Helping High-tech Companies List in the Taiwan Stock Market] (Taipei: Chunghua Institute for Economic Research, 1999).

[51] Indeed, the clearest statement I could find of this issue-linkage was a speech delivered by Hsu in 1983: Li-teh Hsu, 'Financial Reform in the RoC – Employing a Financial System Designed to Spur the Development of Science and Technology' [text of a speech delivered at the VIP Dinner of the US-RoC Economic Council in Phoenix, November 1983] in Li-teh Hsu, *Xiandai Caizheng Zhengce Lunshuo* [Fiscal Policy] (Taipei: Ministry of Finance, 1984). I am grateful to Mr Hsu Li-teh for bringing this article and other materials to my attention. Correspondence with Mr Hsu Li-teh, 20 July 2001.

[52] Li-teh Hsu, 'Current Initiatives of the Ministry of Finance' in *Industry of Free China* Vol. 58, No. 1 (July 1982), p. 15.

[53] Hsu, 'Current Initiatives of the Ministry of Finance,' fn. 52, p. 16.

[54] See esp.: Li-teh Hsu, 'Dangqian Caizheng Sichao yu Wo Guo Caizheng Zhengce' [Current Financial Trends and RoC Financial Policy] in *Taiwan Zhengquan Shichang* [Securities Markets of Taiwan] (Taipei: Ziyou Xinwen She, 1982).

3. The KMT policy windows for securities reform, 1980 and 1987

While many of the ideas Li Kwoh-ting, Hsu Li-teh and the development technocrats were promoting seem perfectly reasonable now, for the time and context they were counterintuitive if not radical. On the face of it, the Taiwan economy had performed very well in the 1960s and 1970s with a highly repressed securities sector. Was radical policy adjustment in the 1980s really so necessary? Although there was strong sympathy among other members of the economic technocracy for the program forwarded by Li and Hsu, at the start of the decade many insiders were urging caution.[55] And not without good reason. The economic technocrats were well aware that securities reform in Taiwan was never going to be possible unless: (1) the KMT regime could see socio-political points to be scored by the exercise, and (2) reform could be shown to buttress the ruling party's conservative finance goals. At least up to 1979, the prospects for the development technocrats to introduce their program for change looked less than ideal.

In due course, however, both of these 'policy windows' would open – although much further apart than those seeking change would have liked. The first of the opportunities for reform came in 1980 when securities liberalization began to assume an air of political expediency for the ruling party. This emergent prospect had deep roots in Taiwan's changing socio-economic structure. In the two decades to 1980, Taiwan recorded an average growth rate of an incredible 9.5% per annum – among the highest in the world for those years.[56] This sustained period of rapid development radically reconfigured the contours of the island's economy: starting out as rural, agricultural and insular in the 1950s, by the late 1970s the Taiwan economy had become urban-centered, industrial and externally oriented (see economic indicators in Table 3.2). These broad socio-economic changes occasioned the emergence of a burgeoning middle class on the island. By 1980, measured in terms of income, more than half of the population could claim to be comfortably average.[57] With a GNP per capital of around US$2,500 and the GINI coefficient at a very respectable .303, most people on Taiwan had transcended the widespread deprivation of the early 1950s and were exhibiting rising standards of consumption. At the start of the 1980s, for example, more than one in four people on the island maintained a registered motor vehicle, and there were more television sets than households.[58] In addition to having satisfied basic material wants, Taiwan's emerging middle

[55] See comments by Premier Y. S. Sun. Yun-shuan Sun, 'Science and Technology in Taiwan's Future Development: Promise and Challenge' in *Industry of Free China* Vol. 59, No. 4 (April 1983).

[56] For a good overview of this period from an economic history perspective, see: Cal Clark, *Taiwan's Development: Implications for Contending Political Economy Paradigms* (New York: Greenwood Press, 1989), p. 174-196.

[57] Thomas B. Gold, *State and Society in the Taiwan Miracle* (Armonk: M.E. Sharpe Inc., 1986), p. 112. Gold cites a two-part magazine article on the emergence of Taiwan's middle class and its political interests that is also worth reviewing. See consecutive issues of: *Shibao Zazhi* [Sunday Times Chinese Weekly] (25 July and 1 August 1984).

[58] From: *Taiwan Statistical Data Book, 1996* (Taipei: Council for Economic Planning and Development, Executive Yuan, 1996), various sections; and *Report on the Survey of Family Income and Expenditure in*

class was also increasingly well educated. By the end of the 1970s, nearly two thirds of those who finished nine years of compulsory education in Taiwan went on to senior high school, and around 45% of senior high graduates went on to tertiary education. In 1979, there were more than 100 institutions of higher learning on the island – for a population of under 18 million, one of the largest number in the world at that time.[59]

TABLE 3.2 Economic transformation on Taiwan – GDP growth rates, sectoral composition and trade as percentage of GDP (selected years 1952-1980)

Period	GDP Growth	Agriculture	Industry	Services	Total Trade
1952	12.0	32.2	19.7	48.1	22.1
1955	8.1	29.1	23.2	47.8	20.9
1960	6.3	28.5	26.9	44.6	30.5
1965	11.1	23.6	30.2	46.2	41.8
1970	11.4	15.5	36.8	47.7	60.8
1972	13.3	12.2	41.6	46.2	78.2
1974	1.2	12.4	40.7	46.9	96.6
1976	13.9	11.4	43.2	45.5	93.5
1978	13.6	9.4	45.2	45.4	98.5
1980	7.3	7.7	45.7	46.6	106.4

Sources: *Statistical Abstract of National Income, Taiwan Area, RoC* (Taipei: Directorate General of Budget, Accounting and Statistics, Executive Yuan, 1996), various sections; and *Quarterly National Economic Trends, Taiwan Area, RoC* (Taipei: Directorate General of Budget, Accounting and Statistics, Executive Yuan, 1996), various sections.

While the emergence of a middle class in the mid to late 1970s by no means guaranteed the emergence of political activism on Taiwan – i.e. there were plenty of other things that were driving people onto the streets – the strong temporal correlation of these social phenomena cannot be dismissed as mere coincidence. Over the course of the 1970s, a new group of middle class intellectuals gradually came of age in Taiwan, and provided an ideational framework for popular discontent against the KMT's authoritarian rule. Many of this new elite were ethnically Taiwanese from rural villages, had received training in the social sciences (in particular political science, law and economics) from universities in North America, and were strong advocates of Western democratic ideals.[60] Their outspoken criticism of the government (typically channeled through quasi-legal journals and magazines like *Xuezhe* and *Meilidao*) struck a cord not only

Taiwan Area, RoC 1994 (Taipei: Directorate-General of Budget, Accounting and Statistics, Executive Yuan, 1994).

[59] Otto C.C. Lin, 'Science and Technology Policy and Its Influence on Economic Development in Taiwan' in Henry S. Rowen (ed.), *Behind East Asian Growth: The Political and Social Foundations of Prosperity* (London: Routledge, 1998), p. 188-190; and *Taiwan Statistical Data Book, 1987* (Taipei: Council for Economic Planning and Development, Executive Yuan, 1987), various sections.

among the island's dissident elements (including, at the extremes, advocates of Taiwanese independence), but also among the KMT's own ranks. The internal reforms of the KMT that followed the rise to power of Chiang Ching-kuo – first Premier in 1972, chair of the ruling party after Chiang Kai-shek's death in 1975, and President of the RoC in 1978 – inadvertently spawned a large group of talented Taiwanese technocrats and politicians within lower levels of the party. This group saw political opening as in their interest, and as the 1970s progressed, a number of them left the KMT to take up leading positions within the developing opposition movement.[61]

Loosely assembled under the banner of the *dangwai* (those political activists and local politicians literally 'outside the party'), the opposition movement was emboldened by the RoC's diplomatic setbacks over the 1970s, and found a practical outlet for its activism in the small number of competitive elections permitted by the ruling party. The RoC's severance of formal ties with some 45 countries between 1970 and 1977 (from 68 to 23) and the loss of United Nations membership in 1971 was a challenge to the KMT's exclusive right to govern, and made the ruling party an easy target for criticism by opposition intellectuals. Against this background, the November 1977 Provincial Assembly elections saw around 30% of the seats taken by *dangwai* delegates, and unexpectedly gave radicals within the opposition movement a predominant voice in strategy-making. Twelve months later, the US withdrew its recognition of the RoC and established full diplomatic ties with the People's Republic of China. In response to this turn of events, the ruling party suspended a planned national election in late 1978, a decision that the opposition took to be an indefinite postponement. Over the course of 1979, the *dangwai* staged a series of increasingly heated demonstrations against the KMT regime's decision, culminating in a violent confrontation with police in Kaohsiung at the end of the year. The regime responded swiftly and harshly to the incident by jailing the most radical of the opposition leaders. The upshot of this move was twofold: it strengthened the hand of moderate elements within the opposition movement, and at the same time increased broad sympathy for the *dangwai*'s aims.[62]

The opening years of the 1980s witnessed the gradual consolidation of the *dangwai* as an enduring feature of Taiwan politics. Content that the opposition's radical voice had been subdued with the Kaohsiung incident, in the middle of 1980 the KMT leadership sought to reinstate elections. In December, a ballot for supplementary seats in the Legislative Yuan was

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[60] See esp.: Mab Huang, *Intellectual Ferment for Political Reforms in Taiwan, 1971-73* (Ann Arbor: Center for Chinese Studies, University of Michigan, 1976); and Tun-jen Cheng, 'Democratizing the Quasi-Leninist Regime in Taiwan' in *World Politics* Vol. 41, No. 4 (July 1989), p. 483.

[61] For detail on the organizational and personnel reforms of the Kuomintang initiated by Chiang Ching-kuo over the 1970s, see: Bruce J. Dickson, *Democratization in China and Taiwan: The Adaptability of Leninist Parties* (Oxford: Clarendon Press, 1997), p. 116-126.

[62] See esp.: Huai-en Peng, *Taiwan Fazhan de Zhengzhi Jingji Fenxi* [The Political Economy of Taiwan's Development] (Taipei: Fengyun Luntan Chubanshe, 1990), p. 216-220. See also: Ralph N. Clough, *Island China* (Cambridge, Mass.: Harvard University Press, 1978), p. 153-154; and Cheng, 'Democratizing the Quasi-Leninist Regime in Taiwan,' fn. 60, (July 1989), p. 486-487.

held with *dangwai* and independent candidates gaining a quarter of the popular vote and 18% of the contested seats. Two years and several successful local elections later, the opposition movement went into another national election and walked away with a similar result. Fearing that the ruling party was becoming adept at manipulating internal divisions within the *dangwai*, in May 1984 the opposition leadership established a defacto secretariat – the Association for Public Policy Research. This institute, while only quasi-legal, functioned to coordinate opposition election strategies and standardize internal policy making. To most onlookers, the formation of the Association was the first step toward the founding of a genuine opposition party on Taiwan; a precursor of the Democratic Progressive Party (DPP – *Minjindang*) formally established in late 1986 (see chapter 5, section three for these later developments).[63]

The rise of middle class opposition to KMT rule detailed above is often portrayed in the literature as one part of a larger account of democratization in Taiwan. While it is not the purpose of this study to delve too deeply into Taiwan's 'great transition,'[64] a few comments on the broader process of political change are probably warranted before proceeding further. After O'Donnell and Schmitter, democratization may be understood to be a process in which the conventions and procedures of democratic rule are applied to political institutions previously subject to authoritarian or arbitrary means of control.[65] Depending on where you start and finish the story, Taiwan's process of democratization covers some of the 1970s, all of the 1980s, and most of the 1990s. Key transition points included the decision to lift martial law in 1987 (which confirmed the rights of free speech and due process in the courts) and the constitutional reforms of the early 1990s (which occasioned the return of elections for all political offices in the RoC state).[66] In searching for an explanation of Taiwan's democratic transition, authors have utilized

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[63] Several clarifications are warranted here. First, in the early 1980s, fear of government suppression meant that the distinction between *dangwai* and independents was often unclear. Particularly in the 1980 election, only the very brave were willing to openly wear the *dangwai* label. For this reason I have included ballot results as a combined figure. This reduction becomes less justifiable as the decade progresses. Figures from: Yun-han Chu, *Crafting Democracy in Taiwan* (Taipei: Institute for National Policy Research, 1992), p. 53-58. Second, some scholars trace the organizational origins of the DPP to the establishment of the Taiwan Dangwai Corps on the eve of the aborted 1978 election rather than the establishment of the Association for Public Policy Research in 1984. Unless one is content to adopt a very open conception of a political party, the extremely loose structure of the Dangwai Corps (more an alliance than an organization) and its transient character make such an assertion questionable. For a view counter to the one put forward here, see: Xiao-feng Li, *Taiwan Minzhu Yundong 40 Nian* [Taiwan's Forty Year Democratic Movement] (Taipei: Independent Evening News, 1988).

[64] The title of Tien Hung-mao's classic study: Hung-mao Tien, *The Great Transition: Political and Social Change in the Republic of China* (Stanford: Hoover Institution Press, 1989).

[65] From: Guillermo O'Donnell and Philippe Schmitter, 'Tentative Conclusions About Uncertain Democracies' in Guillermo O'Donnell, Philippe Schmitter and Lawrence Whitehead (eds.), *Transitions from Authoritarian Rule: Prospects for Democracy* (Baltimore: John Hopkins University Press, 1986), p. 8. This definition conveniently bypasses the question of 'What is democracy?' For all its faults, the definition offered by Huntington still seems to me the most convincing. He defines a democratic political system as one in which '...the most powerful decision makers are selected through fair, honest, and periodic elections in which candidates freely compete for votes in which virtually all the adult population is eligible to vote.' Samuel P. Huntington, *The Third Wave: Democratization in the Late Twentieth Century* (Norman: University of Oklahoma Press, 1991), p. 7.

[66] The list of works that provide an empirical record of Taiwan's democratic transition is long. Among the classic studies in English we can include: Tien, *The Great Transition*, fn. 64; Chu, *Crafting*

the full range of analytical tools, including: economistic arguments about the demand for political opening following a rise in living standards; quasi-constructivist arguments about governments' long-term need to attach a sense of social legitimacy to their decisions; meso-level institutional arguments which point to the path-dependence of political reform while sidestepping the issue of ultimate cause; and 'pure' politics arguments about the strategic interaction between governing and opposing groups.[67] Of these four explanations, the final one has proved the most popular, both in Taiwan and elsewhere.[68] More so than any of the alternative explanations, it gives a crucial role to party politics in Taiwan's democratization – a position that best accords with empirical observation, and is, incidentally, broadly commensurate with the argument of this study.

But to return to more immediate concerns: the story of the rise of the *dangwai* on Taiwan portrayed above is in many ways an ironic tale. The KMT's foresight in listening to the 'right' policy advice in the 1950s was at least partially responsible for Taiwan's outstanding economic success, and it was this success that in turn led to middle class intellectual ferment in the 1970s and organized opposition in the early 1980s. While economic success sowed the seeds of opposition to KMT rule, it also opened up avenues for co-opting and manipulating such resistance. This convergence of events set the stage for the opening of a policy window for securities policy change. We noted in chapter 2 that the KMT's social support base on Taiwan included an eclectic combination of socio-economic groups such as mainland immigrants, Taiwanese farmers and labor. The ruling party had learned quite early that these groups could be bought off or distracted with the appropriate mix of economic and financial policies (from chapter 2, section two). With the rise of the *dangwai*, the KMT moved to reconfigure its distributional coalition to include those agitated segments of the middle class. In the rural areas, this strategy was closely associated with the ruling party's agricultural featherbedding. In addition to being a palliative for farmers, the decision to deepen the commitment to rural protection in the 1970s was also an effective means to win over the rural communities that were home to many *dangwai* intellectuals and activists. Although originally designed by technocrats from the Ministry of Agriculture as a legitimate rationalization of the industry, the so-called Second-stage Agricultural Land Reform (*Dierge Nongye Ludi Gaige*) ended-up as a vast slush-fund. By the early 1980s, virtually everyone living outside Taiwan's main urban centers

Democracy in Taiwan, fn. 63; Peter R. Moody Jr., *Political Change in Taiwan: A Study of Ruling Party Adaptability* (New York: Praeger, 1992); Alan Wachman, *Taiwan: National Identity and Democratization* (Armonk: M.E. Sharpe 1994); and Steven J. Hood, *The Kuomintang and the Democratization of Taiwan* (Boulder: Westview Press 1997). The 1992 Cheng and Haggard edited work is also widely regarded as a key contribution to the debate on Taiwanese democratization: Tun-jen Cheng and Stephan Haggard (eds.), *Political Change in Taiwan* (Boulder: Lynne Reinner 1992).

[67] For overviews, see: Chu, *Crafting Democracy in Taiwan*, fn. 63, p. 2-7.

[68] And includes the exhaustive study by Professor Ji from the National Defence Administration College: Kuang-yu Ji, *Zhonghua Minguo de Zhengzhi Fazhan: Minguo 38 Nian Lai de Bianqian* [Political Development of RoC] (Taipei: Yangzhi Wenhua Chubanshe, 1996), esp. chp. 1.

(Taipei, Kaohsiung, Tainan and Taichung) could expect to benefit from some form of 'rural' subsidy.[69]

While 'buying in' the rural middle class was largely a question of direct subsidization, bringing the richer and more sophisticated urban middle class into the ruling party's distributional coalition was a tougher exercise. Co-opting this group required more subtle means. In this context, from the first year of the 1980s on, the ruling party began to look very seriously at the Taiwan Stock Exchange as a store of valuable social support among urban middle class Taiwanese. There were two aspects to this shift in political outlook. On the one hand, the plethora of individual investors in the local securities sector made it ideally suited to orchestrating an indirect side payment to the target group. In 1979-80, around 54% of investors on the Taiwan Stock Exchange were domestic individuals without any corporate connection, with the remainder shared between government agencies (around 25%), domestic corporate investors (18%) and foreign corporates (3-4%).[70] By comparison, Western stock markets typically make-do with 15-20% individual investors; the lion's share of investment is usually taken up by large mutual funds, pension funds and the like. Moreover, over the decade of the 1970s, investors with portfolios valued between NT$1 and NT$10,000 (roughly US$250) held an average of more than 55% of the total market – around a quarter of a million people in 1980. Investors with between NT$10,000 and NT50,000 held around 34% (around 200 thousand people), with the rest taken up by 'big players.'[71] Any regulatory change that could improve the investment opportunities of small participants in the market would have instant and wide appeal. Securities reform held extraordinary political potential for the KMT regime.

On the other hand, securities reform also held the potential to deliver more bang for fiscal outlay than just about any other form of accommodation strategy. In 1980-81, as Taiwan was reeling from the effects of the second oil shock, the capacity for engaging in a fiscal expansion to offset the rising demands of the urban middle class was decidedly limited. Bleak expectations about future domestic and world growth meant that a repeat of the Ten Major Development Projects of the 1970s was dismissed early on. Also out of the question was another program of direct subsidization *à la* the Second-stage Agricultural Land Reform, or more preferential tax deals of the kind reserved for RoC military personnel and teachers. The

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[69] See esp.: Irene Bain, *Agricultural Reform in Taiwan: From Here to Modernity?* (Hong Kong: Chinese University of Hong Kong, 1993), chp. 2-4. See also: Hsin-huang Michael Hsiao, 'Agricultural Reforms in Taiwan and South Korea' in John Borrego, Alejandro Alvarez Bejar, and Jomo K.S. (eds.), *Capital, the State and Late Industrialization: Comparative Perspectives on the Pacific Rim* (Boulder: Westview Press, 1996).

[70] As most companies in Taiwan at this time were family firms, we can legitimately assume that the figure for domestic corporate investors mentioned here actually included a large proportion of individual investors. Such people would have faced strong incentives to use their company name as a legal cover for their TSE investments so as to reduce personal liability and decrease tax. This implies that the already high figure for individual investors quoted here is probably strongly understated. Interviews in Taipei, 1996 and 1999.

[71] Figures from *SEC Annual Report, 1984* (Taipei: Security and Exchange Commission, Ministry of Finance, 1985), p. 38; and *TSE Fact Book, 1989* (Taipei: Taiwan Stock Exchange Corporation, 1990), p. 56.

onset of recession in 1982 merely reinforced the unrelenting fiscal conservatism that had informed these policy choices.[72] By contrast, securities reform was an easy option for the ruling Party. Simply by loosening the strictures on the issuance and listing of securities, and allowing more investors into the market, the government could preside over a major expansion of the sector with virtually no budgetary sacrifice. Further, while I can find no serious econometric analyses conducted on this question at the time, it is well understood in the economics literature that a rapid expansion of the stock market soon leads to improved overall economic performance. Dollar for dollar invested, the short-term multiplier effect of money poured into bonds and shares is consistently greater than similar quantities of investment in real estate, infrastructure, plant and equipment, or human capital development.[73] Securities reform was not only politically palatable, it was also potentially efficient and effective as well.

It is apparent from the discussion above that a socio-political window of opportunity for securities reform gradually opened within the KMT regime at the start of the 1980s. For the first time in the history of RoC securities administration, reform became an important political tool for the ruling party; as a means to provide side payments to Taiwan's newly politicized middle class, securities liberalization held enormous potential. We will examine in the following section of this chapter just how the development technocrats turned this chance for change into a discernible reform program, but for now the question remains: If securities reform became politically palatable for the ruling party around 1980, why did the actual reform process drag out for more than a decade? The short answer to this question is that *there was nothing intrinsically wrong with the securities sector* when reform first started. In purely economic terms, of course, Taiwan's securities markets were an unmitigated disaster. They were totally inadequate to the task of financing most established firms in Taiwan, not to mention the new breed of high-tech companies our development technocrats were eager to encourage. Local securities markets were also an extraordinarily risky place to store one's savings; with no reliable way of assessing the performance of listed firms, investment decisions were more often than not purely a function of the herd instinct.[74] However, in terms of the sectoral priorities of

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[72] Various interviews with MoF and CBC officials in Taipei, 1996 and 1999. See also: CEPD, 'Macroeconomic Planning for Taiwan, Republic of China' in *Industry of Free China* Vol. 53, No. 6 (June 1980), esp. p. 18-19 & 24; CEPD, 'Prospects for Economic Development, Targets and Measures' [excerpts from the RoC's Four-Year Development Plan, 1982-'85] in *Industry of Free China* Vol. 57, No. 3 (March 1982); and Cheng-chi Chang, 'RoC Fiscal Policy and Development Financing' in *Industry of Free China* Vol. 52, No. 6 (December 1979). For a critique of the government's fiscal conservatism at this time, see: Ching-huei Chang, 'Public Finance' in Gustav Ranis (ed.), *Taiwan: From Developing to Mature Economy* (Boulder: Westview Press, 1992).

[73] Indirectly, I am indebted to Dr. Cheng You-ping from Chung-hsing University for this point. Although Dr Cheng raised the issue in connection with government interventions in the stock market during the late 1990s, the idea that there is a strong multiplier effect from an upturn in securities investment is basically the same. Interview in Taipei with Dr. Cheng You-ping, Associate Professor, Department of Public Administration, National Chung-hsing University, 26 March 1999.

[74] According to mainstream economic theory, securities markets have two purposes: (1) to provide companies with a way of issuing shares, bonds and other financial instruments to people with funds to invest, and (2) to provide investors with a safe and reliable avenue for the buying and selling of shares and other securities instruments. Data provided in chapter 1, section one of this study and below suggest

the ruling party, the local markets for debt and equity were quite satisfactory. Insofar as securities transactions on Taiwan were diverted into relatively 'safe' channels, and the sector was comparatively small and isolated from the rest of the economy, the KMT regime's preferences for a stable and controllable financial system were satisfied. That is to say, at the start of the 1980s, the 'sectoral-strategy window' for securities policy change was well and truly closed. Even though securities reform at that time had become expedient in a socio-political sense, it would take another eight years before reform would become an entirely judicious strategy for the ruling party.

For most onlookers, the operation of Taiwan's securities markets in the pre-reform era was exemplified by the island's main secondary market, the wild and unruly Taiwan Securities Exchange. From its establishment in the 1960s through the late 1980s, the TSE routinely exhibited strong fluctuations on all major trade indicators (see Table 3.3 for select TSE trade data).[75] These figures give credence to the popular view of the old TSE as a 'casino,' a reputation that was well established by the time the development technocrats began talking about securities liberalization at the start of the 1980s.[76] However, while the internal flows of the Exchange were chaotic, in broad structural terms Taiwan's securities sector was consistent with the ruling party's sectoral goals of stability and control, at least up to 1987. As suggested above, there were two features of the local securities sector that ensured this congruence. Firstly, the KMT regime had had considerable success domesticating or 'sublimating' the local trade in securities services. Usually this involved taking a widespread but illegal securities practice and transforming it into a tightly managed but legal process. This diversionary method had its origins in the 1950s.[77] The virtual ban on securities trading at that time had ironically generated a thriving but illegal over-the-counter market in equities and bonds. Some of the most prized instruments in this spontaneous free market were, paradoxically, government securities issued as part of the monetary stabilization plan of the early 1950s (so-called

that in the early to mid 1980s, Taiwan's securities markets failed dismally in performing either function. See: Edward W. Davis and John Pointon, *Finance and the Firm: An Introduction to Corporate Finance*, 2nd ed. (New York: Oxford University Press, 1994), esp. chp. 21 & 22.

[75] For those interested in the economics of TSE volatility at this time, see: Si-cong Lin and Song-nan Chen, 'Taiwan Gushi Gao Fudu Biandong de Zhuyin yu Qidui Shehui Caifu ji Fuli Cuoshi de Yingxiang' [The Real Causes of High Volatility in Taiwan's Stock Market and its Impact on the Social Wealth and Welfare], report commissioned by the National Science Commission of the Executive Yuan, produced under the auspices of the Department of Finance Administration, National Zhongshan University (31 January 1995).

[76] See comments by Caldwell in the mid 1970s: J. Alexander Caldwell, 'The Financial System in Taiwan' in *Asian Survey* Vol. 16, No. 7 (August 1976), p. 742.

[77] The practice of co-optation and diversion was not restricted to finance. Any outsider who has spend much time in Taiwan knows that the visa laws follow a similar pattern of evolution. A more transparent and closely researched case is policy for television and broadcasting. Early attempts to limit TV ownership and distribution (including an unwieldy TV licensing process) in the 1950s and 60s, for example, were scrapped when they were discovered to be unenforceable. Instead the government opted for control over broadcasting and maintained a controlling interest in the three free-to-air TV stations. See in particular: Fu-chu Li, 'The Development of Television Broadcasting in Taiwan, RoC' unpublished Masters manuscript, University of North Texas (1983); and Shi-guang Wen, *Zhongguo Guangbo Dianshi Fazhan Shi* [The Development of Television Broadcasting in the RoC] (Taipei: Sanmin Shuju, 1983).

'Patriotic Bonds') and the 'land to the tiller program' of 1954. Instead of cracking down on this emerging market, however, the KMT regime choose to channel it into a centralized institution – hence the Taiwan Securities Exchange was born. In terms of flexibility, access and allocative efficiency, the new Exchange proved a poor substitute for the original over-the-counter market, but it was docile and easy to supervise. Over the 1960s, 'competition' from the centralized market partially offset the need for illegal alternatives, and securities trades in the underground economy gradually wound-down as a result.[78]

TABLE 3.3 Summary trade data, TSE index, 1972-1993

Period	Year Index	High/Low	Period	Year Index	High/Low
1972	161.15	228/125	1983	654.28	766/435
1973	371.73	515/226	1984	872.51	969/765
1974	349.20	498/189	1985	745.62	841/636
1975	317.48	429/190	1986	944.74	1,039/840
1976	343.04	417/258	1987	2,135.03	4,673/1,063
1977	362.45	450/314	1988	5,202.21	8,790/2,341
1978	554.13	689/448	1989	8,616.14	10,773/4,873
1979	560.51	659/502	1990	6,775.32	12,495/2,560
1980	564.91	560/480	1991	4,928.83	6,305/3,316
1981	548.84	601/503	1992	4,271.63	5,392/3,328
1982	477.20	546/421	1993	4,214.78	6,071/3,136

Notes: High/Low figures have been rounded to the nearest unit. TSE Index = (Pt*Qt/P0*Qt)*100. Pt*Qt is the daily closing price listed stocks multiplied by the daily trading volume of those stock. P0*Qt is the daily trading price of listed stocks on the base year of calculation (1966) multiplied by the trading volume of those stock on the base year.
Source: *Taiwan Zhengquan Jiaoyisuo Zhengquan Tongji Ziliao, Minguo 84 Nian* [Taiwan Stock Exchange Statistical Data 1995] (Taipei: Taiwan Stock Exchange, 1996).

The second feature of the local securities sector that ensured congruence with the ruling party's finance goals concerned the sector's size and external linkages. The Taiwan Securities Exchange and sibling markets were simply too small and detached to affect the remainder of the RoC financial system, much less the overall economy. We noted in the first chapter of the thesis that stocks and bonds constituted a very small proportion of the funds sourced by publicly issued corporations on Taiwan prior to the late 1980s (around 11%).[79] As of 1985, the number of firms listed on the local exchange was just 127. From 1970 to 1985, new listings averaged no more than five per year (see Table 3.4 for details). The comparative figures for market

[78] *SEC Annual Report, 1994* (Taipei: Securities Exchange Commission, Ministry of Finance, 1995), p. 7-8; *TSE Fact Book, 1995* (Taipei: Taiwan Stock Exchange, 1996), p. 6; and *RoC Securities Market Annual, 1992*, fn. 8, p. 13-18.
[79] See: Ya-Hwei Yang, Shyuan-Yi Shiau, Wen-Jeng Kuo, Lee-Rong Wang and Meng-Cheng Liu, *The Development of Small and Medium-Sized Enterprises in the Republic of China, Volume 3, The Financing and Marketing Ability of Taiwan's SMEs* (Taipei: Pristine Communications, 1995), p. 27-29.

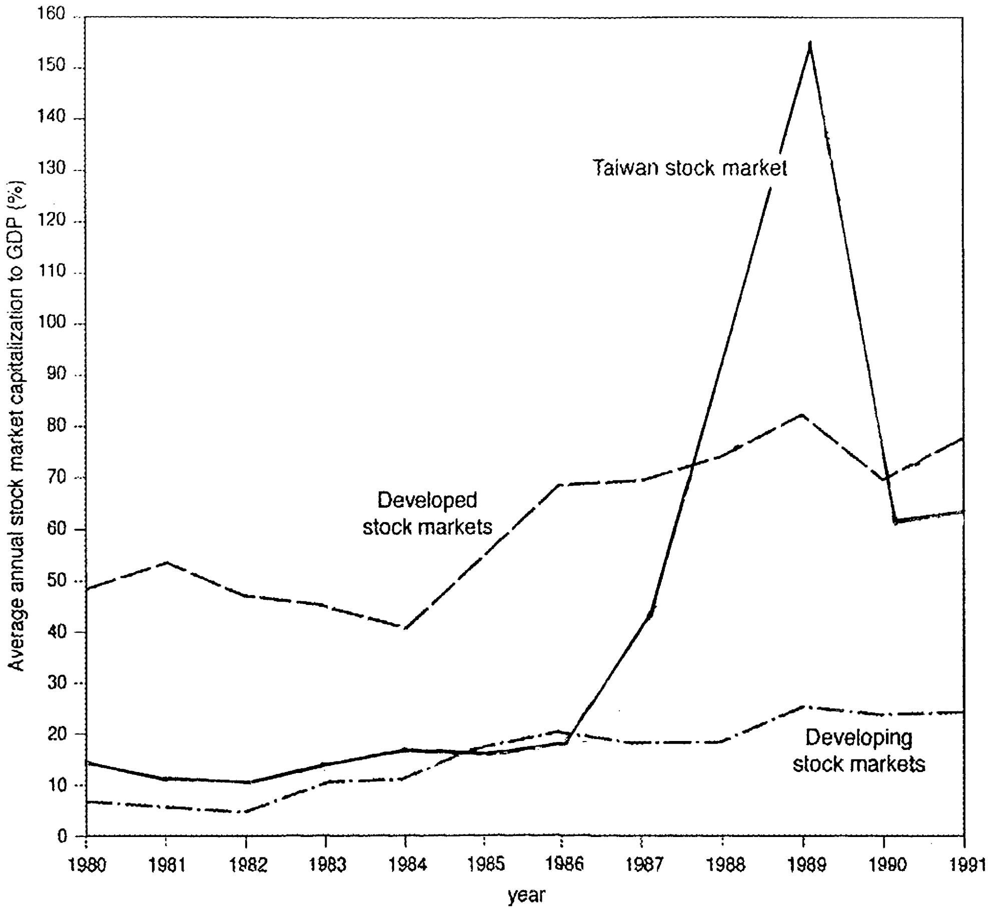
capitalization to GDP also leave little doubt that the securities sector in Taiwan was radically undeveloped (see also Table 3.4). In the 15 years to 1985, TSE capitalization to GDP averaged just 13.3% (with 12.5% for the decade of the 1970s, and 14.0% for the years 1980 to 1985). Figures such as these place Taiwan firmly among those countries with developing stock markets in the early to mid 1980s (not to be confused with the stock markets of developing countries *per se* – note the following country case studies). Utilizing time series data from the International Finance Corporation's Emerging Markets Data Base, Demirguc-Kunt and Maksimovic point to a large gap between the capitalization ratios of developing stock markets (including markets in Mexico, Jordon, India, Norway, Austria, France, Spain, New Zealand, Belgium, Italy, Finland, Zimbabwe, Pakistan and Turkey) and those of well established markets (including Hong Kong, Japan, Germany, the United Kingdom, the US, Singapore, Switzerland, South Africa, Malaysia, Korea, Thailand, the Netherlands, Australia, Canada and Sweden).[80] As can be seen from Diagram 3.1, Taiwan was very much a member of the former group up to 1986-87. Finally, reflecting the weak links between local securities markets in Taiwan and the domestic and international economies, asset pricing in the Taiwan Stock Exchange only tacitly reflected peaks and troughs in external markets. Indicative of this variance, at least one study has suggested that at various times similar assets in US stock markets and the TSE *differed by as much as a factor of 15.*[81]

But as the 1980s progressed, the KMT regime's satisfaction with the old regulatory arrangements for securities altered radically. Around 1987, the structure of Taiwan's securities markets changed in ways that totally undermined the ruling party's finance goals – a sectoral-strategy window of opportunity for securities reform was about to open. There were two aspects to this. On the one hand, illegal practices once again became a systemic characteristic of the securities sector. Although by the early years of the 1980s illicit trading on the Taiwan Stock Exchange (stock manipulation, insider dealing and so on) had become increasingly prevalent, transactions were still safely channeled through the centralized institutions established some two decades before. Around 1983-85, however, a new group of underground investment firms came into being. Utilizing a loophole in the Banking Law that blurred the distinction between deposits and smallholder investment, quasi-legal companies such as Hung Yuan, Fortune, Yuan Ann and Cheng Wei gradually became major players on the TSE and spawned a variety of black derivative markets. Around 1987, spurred on by the appreciation of

[80] The initial split between developing and developed stock markets was based on a composite index of stock market capitalization to GDP, total value of shares traded to GDP, and the total value of shares traded to capitalization. See: Asli Demirguc-Kunt and Vojislav Maksimovic, 'Stock Market Development and Financing Choices of Firms' in *World Bank Economic Review* Vol. 10, No. 2 (1996), p. 348 & 359.

[81] See: Robert A. Korajczyk, 'A Measure of Stock Market Integration for Developed and Emerging Markets' in *World Bank Economic Review* Vol. 10, No. 2 (1996). Supplemented with historical and anecdotal data from: *Taiwan Zhengquan Jiaoyisuo Zhengquan Tongji Ziliao, Minguo 84 Nian* [Taiwan Stock Exchange Statistical Data 1995] (Taipei: Taiwan Stock Exchange, 1996), p. 2-3; and interviews with economists in Taipei, 1996.

DIAGRAM 3.1 Market capitalization, Taiwan vs developed and undeveloped markets



Notes: Developing stock markets include those of: Mexico, Jordan, India, Norway, Austria, France, Spain, New Zealand, Belgium, Italy, Finland, Zimbabwe, Pakistan, and Turkey. Developed stock markets includes: Hong Kong, Japan, Germany, the United Kingdom, the US, Singapore, Switzerland, South Africa, Malaysia, Korea, Thailand, the Netherlands, Australia, Canada, and Sweden.
Sources: Robert A. Korajczyk, 'A Measure of Stock Market Integration for Developed and Emerging Markets' in *World Bank Economic Review* Vol. 10, No. 2 (1996); and *Taiwan Zhengquan Jiaoyisuo Zhengquan Tongji Ziliao, Minguo 8 Nian* [Taiwan Stock Exchange Statistical Data 1995] (Taipei: Taiwan Stock Exchange, 1996). The author is grateful for assistance from Kay Dancey for the production of this chart.

the NT dollar and increasing media attention, these firms shrugged off any pretense of being secretive and began appealing directly to the public for funds. And despite the highly suspect nature of the firms' business dealings (most were little more than ponzi schemes), the public came in droves. Before reaching the height of their business activities in early 1989 and then gradually imploding thereafter, the underground firms amassed an estimated NT$220 billion in accumulated 'deposits' from over 400,000 people in Taiwan. Analysts estimated that as the stock market took-off through 1987-88, about 30% of the TSE's daily trading volume came from orders placed by these firms. The local stock exchange was no longer a docile avenue for securities trading. Illegal securities practices had become a major part of the very fabric of the market.[82]

On the other hand, the size and external linkages of the securities sector grew in an extraordinary fashion. From 1987 on, the assumption that Taiwan's securities markets were small and would remain that way indefinitely ceased to hold. After a spike in trading activity in late 1986, the level of capitalization of the Taiwan Stock Exchange jumped from an accumulated total of around 20% of GDP at the end of 86 to 42.8% in 1987 (see Table 3.4). In 1988 and 89, the ratio of market capitalization to GDP expanded to unbelievable heights – 96% and 156.7% respectively. For the entire period from 1986 to 1990, the ratio of TSE capitalization to GDP was an average of 75.3%, a fivefold increase over the 14% average for the period 1980-85. As can be seen from Diagram 3.1, this dramatic increase in market size lifted Taiwan into the ranks of those countries with developed stock exchanges – a position it more or less retained after the collapse of stock trading in 1990 (for the years 1990-95 the TSE capitalization to GDP ratio averaged 73.2% per annum).

At around the same time as this huge leap in market size was occurring, the stock market was beginning to interact with the rest of the economy in new and unpredictable ways. The bubble in the TSE during this period was closely associated with a bubble in the real estate sector, one of the few markets in Taiwan that could claim to be almost totally unregulated at the time. In the two and half years to October 1989, housing prices rose by almost 250% in some areas of Taipei and Kaohsiung. Anecdotal evidence suggests that even small-time investors were managing a sophisticated portfolio of property, stocks and other assets. One story reported in a local magazine has a small businessman dedicating his mornings to the stock exchange, his afternoons to the property market, and his evenings to his clothing store.[83] Perhaps more worrying for the ruling party, however, was the emerging connection between the appreciation of the NT dollar, the inward flow of speculative 'hot money,' and the increase in TSE trading volume. Faced with strong expectations of NT dollar appreciation, speculators were making a killing buying in and out of the local currency, and taking the opportunity to play the stock market in the interim. While there are no reliable statistics for the amount of money doing this circuit, estimates suggest that around US$10 billion in hot money flowed into Taiwan in the 12

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[82] Data and comments from: *Jingji Ribao* [Economic Daily News] (13 September 1989), p. 2; Henny Sender, 'Taiwan: The Wild East' in *Institutional Investor* [international edition] (October 1989); *Xin Xinwen* [The Journalist] (15 January 1990), p. 10-31; and Chun-I Chen, 'Underground Investment Firms in the Republic of China on Taiwan: A Comparison with the Development of Banking Law in the United States' in *Chinese Yearbook of International Law and Affairs* Vol. 10 (1990-1991). Supplemented with interviews in Taipei, 1996. Especially grateful to Dr Chung-hsing Chen, President, Institute of Securities and Futures Markets Development, 30 August 1996.

[83] Story from: *Tianxia Zazhi* [Commonwealth Magazine] (1 October 1988), p. 168-171. Figures on housing prices from: *Asia 1990 Yearbook* (Hong Kong: Far Eastern Economic Review, 1990), p. 232.

months to June 1987 and maybe half of this amount found its way into the TSE (more on the appreciation of the NT dollar and the influx of hot money in chapter 4).[84]

TABLE 3.4 TSE size – market capitalization and listings, select years 1970-1995

Period	Market Capitalization	Capitalization to GDP	Number of Listed Firms	Number of Listed Shares
1970	16,970	7.4%	42	1,262
1975	73,959	12.5%	68	3,458
1980	219,053	14.6%	102	10,659
1981	201,331	11.3%	107	12,805
1982	203,111	10.6%	113	15,144
1983	305,956	14.5%	119	16,716
1984	390,260	16.6%	123	19,039
1985	415,706	16.8%	127	21,345
1986	548,436	19.2%	130	24,082
1987	1,386,065	42.8%	141	28,735
1988	3,383,280	96.0%	163	34,358
1989	6,174,164	156.7%	181	42,130
1990	2,681,911	62.2%	199	50,643
1995	5,108,437	73.9%	347	132,462

Sources: *Taiwan Zhengquan Jiaoyisuo Zhengquan Tongji Ziliao, Minguo 86 Nian* [Taiwan Stock Exchange Statistical Data 1995] (Taipei: Taiwan Stock Exchange, 1998) and *Taiwan Statistical Data Book, 1996* (Taipei: Council for Economic Planning and Development, 1996). Calculations on the ratio of capitalization to GDP performed by the author.

In sum, through 1987 Taiwan's securities sector became structurally unstable and uncontrollable. The second KMT policy window– i.e. the sectoral-strategy window – had finally opened reinforcing the socio-political imperative to reform the securities sector. After a hiatus of nearly eight years, complete reform of the securities sector was at last a serious political option.

4. Leading the long march

In the discussion above we have seen how, in 1980 and then again in 1987, securities reform gradually emerged as a prudent political strategy for the ruling party. The correlation of the KMT's two policy windows with the process of securities reform detailed in section one of this chapter is readily apparent: reform starts after 1980 as the socio-political window opens, and then climaxes (and ultimately concludes) in the wake of the 1987 opening of the sectoral-strategy window. But while the opening of the two policy windows in 1980 and 1987 was a

[84] *Tianxia Zazhi* [Commonwealth Magazine] (1 June 1987), p. 94; and *Far Eastern Economic Review* (18

necessary precondition for securities reform, it did not guarantee that reform would automatically occur. For that, sustained and calculated effort by interested technocrats was required. At this point in the reform story, our development technocrats re-enter the analysis. I would argue that Li Kwoh-ting, Hsu Li-teh and the other development technocrats seized these two opportunities to launch and eventually conclude their agenda for securities reform. What evidence do we have to support this claim?

To substantiate the argument, I point to three items of evidence, based on criteria that we will return to throughout the course of this thesis. These criteria include: (1) evidence of increased reform effort on behalf of the technocrats concerned at the time when the relevant policy windows opened, (2) evidence of technocrat awareness of the relevant policy windows, and (3) counterfactual evidence discounting the influence of alternative actors or social forces.[85] To begin with, it is clear that immediately after the two KMT policy windows opened in 1980 and 1987, the development technocrats became more active in their pursuit of securities reform. At the start of the decade, this change in behavior can be observed in the reform efforts of a number of the group (e.g. it was Suan Yun-suan's decision to loosen margin financing on the TSE in April 1980), but was most pronounced with the ascendancy to Cabinet of Hsu Li-teh in 1981. Hsu was made Minister of Finance in October and his appointment presaged a period of Executive Yuan dominance by the friends of Li Kwoh-ting.[86] Upon assuming office, Hsu immediately poured his enthusiasm into a range of policy initiatives, including everything from tax reform to the establishment of a local venture capital industry.[87] Opening up the stock market was a primary concern for the new Finance Minister. In November, Li gave the nod to the Securities Exchange Commission to draw up a schedule for market opening, and just less than 12 months later he launched the plan to permit foreign investment in the Taiwan Stock Exchange.[88] While Hsu enjoyed the limelight at this time, his mentor Li Kwoh-ting was content to work quietly behind the scenes 'smoothing over' intra-KMT opposition to reform and advising the other technocrats. On at least one occasion in early 1983, this entailed twisting the arm of military strongman Soong Chang-chih to loosen controls on cross-boarder telecommunications, a key adjunct to foreign financial transactions. Elsewhere, press reports

June 1987), p. 58-59.

[85] It is intended that these three items of evidence be viewed as a package. Taken together, they present a strong case for some form of agency, while apart they may appear nondescript or even trite.

[86] This left the Executive Yuan with four development technocrat heavy-weights: Suan Yun-suan as Premier, Hsu Li-teh as Minister of Finance, Chao Yao-tung as Minister of Economic Affairs, and Li Kwoh-ting as Senior Minister of State. *Far Eastern Economic Review* (30 April 1982), p. 49-51.

[87] See esp.: Li-teh Hsu, 'Dangqian Caizhengbu Jidai Tuidong de Gongzuo' [Current Tasks Urgently in Need of Pursuit by the Ministry of Finance – originally for a press conference conducted in December 1981] in Li-teh Hsu, *Xiandai Caizheng Zhengce Lunshuo* [Fiscal Policy] (Taipei: Ministry of Finance, 1984).

[88] Which lead to the establishment of the Securities Investment Trust Enterprises in the middle of 1983. From: *Zhongyang Ribao* [Central Daily News] (16 July 1983), p. 1; *Zhongguo Shibao* [China Times] (26 July 1983), p. 1; and interview in Taipei with Dr Chung-hsing Chen, President, Institute of Securities and Futures Markets Development, 30 August 1996.

and rumor maintained that Li was the 'inspiration' behind the decisions to establish the Fuh Hwa Securities Company and open the stock market.[89]

Increased reform effort is also observable after 1987, although by this time such effort was largely specific to those development technocrats closely engaged with the securities sector, particularly those located within the Securities Exchange Commission. Some of this reform activity is difficult to observe due to the institutional subservience of the SEC to the Ministry of Finance (review Diagram 2.1 in chapter 2, section one). Often, actions taken within the former institution were officially ascribed to the latter,[90] concealing some interesting behavioral patterns among SEC personnel. This said, at least two development technocrats within the SEC quite visibly stepped up their participation in reform: consecutive SEC Chairmen Shen Pe-ling and C.P. Chang. Shen was SEC chairman from 1984 to early 1988 and had a major role to play in the drafting of the new Securities Exchange Law. The events beginning in 1987 saw Shen involved in efforts to jostle the new law through the Legislative Yuan (finally passed in January 1988), and prepare the SEC for a substantial increase in administrative responsibilities and functions.[91] C.P. Chang, SEC chairman from early 1988 to 1993, is the technocrat most closely associated with the decision to allow new securities companies into the market in mid 1988. Journalists and coworkers attribute Chang with the very liberal admission standards contained within the 'Criteria for the Establishment of Securities Firms,' and the subsequent flood of new firms into the industry.[92] Meanwhile, moral support for the efforts of these development technocrats was forthcoming from a number of old hands, including: Chao Yao-tung, Lee Ta-hai, soon-to-be retired Li Kwoh-ting and even the outcast Loh Jen-kang (who fell from grace along with Hsu Li-teh in 1985).[93]

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[89] *Far Eastern Economic Review* (25 August 1983), p. 98; *Far Eastern Economic Review* (10 March 1983) p. 39; and *Zhongguo Shibao* [China Times] (5 July 1981), p. 6. See also: *The Free China Journal* (29 January 1999), includes an article on the development of high-tech firms in Taiwan, available online at http://www.teco.org.au/whatnew_990138.html – viewed on 9 September 2000. Supplemented with interviews in Taiwan, 1996.

[90] A situation that SEC technocrats occasionally found intolerable enough to complain to the press about. See e.g.: *Tianxia Zazhi* [Commonwealth Magazine] (1 October 1988), p. 152.

[91] Compare interviews with Shen in 1986 and late 1987: Chen, 'Only a Healthy Market Can Guarantee Progress: Interview with Shen Pe-ling, Chairman of the Securities Exchange Commission,' fn. 15; and Claire Chen, 'With Deregulation, Securities Houses Can Operate More Efficiently: Interview with Shen Pe-ling, SEC Chairman' in *Financial and Investment Yearbook, RoC 1988* (Taipei: China Economic News Service, 1988). In the former Shen talks about planning for securities reform, while in the latter he describes efforts to implement reform measures.

[92] *Tianxia Zazhi* [Commonwealth Magazine] (1 October 1988), p. 162, includes personal interview with Chang. Supplemented with interviews in Taipei, 1996 and 1999, esp. interview with Gordon S. Chen, Director of the 4th Department, Executive Yuan (and ex-Chair of the Securities Exchange Commission), 20 July 1999.

[93] See variously: Philip Liu, 'Economic Policy to Emphasize Imports, Quality and Services: Interview with T.H. Lee, Minister of Economic Affairs' in *Financial and Investment Yearbook, RoC 1988* (Taipei: China Economic News Service, 1988); *Tianxia Zazhi* [Commonwealth Magazine] (1 June 1987), p. 91-103; *Tianxia Zazhi* [Commonwealth Magazine] (1 January 1988), p. 79; *Tianxia Zazhi* [Commonwealth Magazine] (1 October 1988), p. 188-190; and *Tianxia Zazhi* [Commonwealth Magazine] (1 April 1989), p. 69-70. Includes quotes and commentary from said individuals. Supplemented with interviews in Taipei, 1996 and 1999.

The second item of evidence to confirm the case for leadership by the development technocrats concerns their awareness of the KMT policy windows after 1980 and 1987. Specifically, the way in which the development technocrats sought to market their securities reform efforts at these two junctures reveals a lot about the political context in which they operated. Among Li Kwoh-ting's public presentations of the early 1980s, for example, we find that there is almost always an appeal to the middle class, often portrayed heroically as the backbone of the new economy. This group is invariably included alongside a more natural audience for his development ideas: the captains of industry in Taiwan, the science establishment, government agencies and academic economists. Although Li had always shown a concern for the social aspects of economic development, after 1980 this issue linkage became more concerted and more direct. In a speech presented in 1981, for example, Li expressly targeted white-collar workers, saying:

> Our economy in the 1980s is going to be market-oriented. I cannot overstress the importance of the salesman [in this new economy], especially in view of the rapidly changing international business environment, with its many uncertainties. The new salesman must be well educated, knowledgeable in modern business developments and practices, and well informed of local market conditions in different countries. He is a new creature – no longer the kind which has been manipulated and exploited by foreign traders....[94]

Elsewhere, Li even spoke to the moral sensibilities of the emergent middle class. In a newspaper article in 1981, he addressed widespread fears of a decline in social ethics amidst Taiwan's newfound prosperity. He claimed that traditional Chinese culture, with its emphasis on community harmony and family, would keep a check on some of the more undesirable effects of material affluence and urbanization.[95] Pandering to the middle class was also a tactic Hsu Li-teh employed around this time, although somewhat less subtly than his mentor. In a speech to the American Chamber of Commerce in May 1982, for example, the Minister commenced with an extended treatise on social change in Taiwan. Some of the topics covered in this unusual section of an otherwise standard ministerial address included the emergence of new vocational attitudes among professionals on Taiwan, the rise of social pluralism and the decline in traditional modes of authority. Naturally, mindful of the need to push through his reform program, the Minister welcomed these changes with open arms.[96]

The development technocrats' rhetoric after 1987 confirms a similar appreciation of KMT sensibilities. Dovetailing with their substantive efforts at this time, the development technocrats

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[94] Li, *Economic Transformation of Taiwan, RoC*, fn. 48, p. 99-100.
[95] *Lianhe Bao* [United Daily News] (28 March 1981), p. 3.
[96] Hsu, 'Current Initiatives of the Ministry of Finance,' fn. 52, p. 11-12. This was not just a case of indulging a foreign audience. See similar comments in: Li-teh Hsu, 'Zhengfu de Zhichu Ji Renmin de Fudan' [Government Expenditure to Support the Burden of the People – an address to staff at Taiwan Normal University in January 1983] in Li-teh Hsu, *Xiandai Caizheng Zhengce Lunshuo* [Fiscal Policy] (Taipei: Ministry of Finance, 1984).

almost exclusively presented securities reform as an attempt to rein in industry excesses. Indeed, given their public announcements, one could be forgiven for thinking that the 1988 Securities Exchange Law (and subsequent ordinances) was simply a reactionary crackdown[97] on illegal or unregulated securities issuance and trading. In press interviews and media reports, the development technocrats rarely celebrated securities reform as a new dawn for securitization and sectoral development in Taiwan; the official focus was market stability and control. In a newspaper interview in late 1988, C.P. Chang claimed that one of the key improvements of the new Securities and Exchange Law was the fact that it contained

> '...far more complete regulations concerning insider trading. Aside from the original Article 157, which stipulates that all profits from short-swing purchases or sales conducted on inside information shall be returned to related companies, Section 1 of the article poses criminal liability as well. Now, any director, officer or beneficial owner who unlawfully manipulates the market and earns profits by using unrevealed inside information will be liable to imprisonment for up to two years.'[98]

Twelve months later, in another interview, Chang continued the theme, although this time he was adamant to demonstrate that the new regulatory structure was getting results. He commented that '[s]ince the revised Securities and Exchange Law took effect in February 1988, we have uncovered over 500 cases involving the illegal transfer of shares by board members, insider trading and manipulation.'[99] Although this symbolic appeal to stability and control ensured an audience for securities reform within the KMT regime, it must be remembered that the new regulatory system put in place after 1988 was far from a tool of repression (we have seen elsewhere just how much it served to open up the securities sector). For the development technocrats selling the new regulatory scheme, however, the larger agenda of securities liberalization and expansion was seldom articulated voluntarily.

And finally, consider the counterfactual question: what if the development technocrats *were not* the agents responsible for securities liberalization? Answering this question implies we look at two things: (1) possible alternative actors within the KMT regime, and (2) possible alternative

[97] It strikes me that the regulatory changes involved in securities reform can be broken down into two subcategories, preemptive and remedial. Preemptive regulatory change is an administrative means to a market end, and is concerned with: (1) defining and creating new markets, and (2) placing limits on anticipated market behavior. It is forward looking and novel. This kind of regulatory activity attracts a lot of interest from authors who are surprised by just how extensive the body of new rules can be – see esp. Vogel, *Freer Markets, More Rules*, fn. 27, chp. 5. Remedial regulatory change, by contrast, is concerned with cleaning-up the excesses of an *existing* securities sector that is perceived to be in some sense intrinsically 'problematic.' This kind of rule making is backward looking and reactive. The proportion of preemptive versus remedial regulatory change in any one case of securities opening tells us something about the initial politico-economic context of reform. I am indebted to a discussion with Sandra Eccles for these points.

[98] Tian Hsueh, 'The Question is How to Implement New Rules Against Insider Training' in *Financial and Investment Yearbook, 1989* (Taipei: Central Economic News Service, 1989), p. 92.

[99] William Yang, 'Investors Should Have the Concept of Long-Term Investment' in *Financial and Investment Yearbook, 1990* (Taipei: Central Economic News Service, 1990), p. 79.

actors or social forces external to the KMT regime.[100] The case for an alternative agent for change emerging within the KMT regime appears, superficially at least, quite strong. We know that in March 1981, President Chiang Ching-kuo delivered a very public call for the development of a 'healthy and active capital market' in Taiwan[101] – at least insofar as the securities reform initiatives of the early 1980s are concerned, perhaps the buck stops with CCK. Although plausible, attributing securities reform to President Chiang fails on two counts. First, the timing is suspect. While CCK's early call for reform certainly preempted the decision to reorganize the Securities Exchange Commission in July 1981, it occurred fully 12 months *after* the decision to establish the Fuh Hwa Securities Company. Securities reform was well into the takeoff phase by the time the President's order came through; the order buttressed an existing process rather than triggering a new course of action.[102] Second, it is very unlikely that, absent advice from the development technocrats, CCK would have independently embarked upon a policy of securities reform (much less understood the political potential of such a strategy). We know that on more than one occasion CCK admitted that he was 'not an economist,' and understood his own strength in economic policy formulation as a willingness to listen to the good counsel of others.[103]

But what of other technocrats or, indeed, other Presidents? We know that after 1987, the development technocrats were not in the ascendancy within Cabinet. Around this time, the finance technocrats and then the young reformers were the preeminent factions.[104] Furthermore, unlike the situation with President Chiang Ching-kuo, the inauguration of Lee Teng-hui in early 1988 brought a ruler to office who understood the technical issues at hand. Li was an economist by training and held a PhD from Cornell University – perhaps he initiated the securities reform push after 1987.[105] While it is almost certain that other policy elites assisted the development technocrats with securities reform, there is little evidence to suggest that the likes of Robert Chien (Finance Minister from 1985 to mid 1988) and Shirley Kuo (Finance Minister from mid

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[100] Again, we will return to these sub-categories throughout the course of the case-study chapters. Readers will note that some of the evidence we will examine under these two categories is partially derived from the four theoretical approaches to financial liberalization considered in chapter 1 of the thesis.

[101] This was the one and only time that CCK spoke-out publicly on the issue of securities reform. As recorded in: *Far Eastern Economic Review* (28 August 1981), p. 87.

[102] *Far Eastern Economic Review* (28 August 1981), p. 87-88; and *Far Eastern Economic Review* (9 October 1981), p. 78-81. Supplemented with interviews with finance officials in Taipei, 1996 and 1999.

[103] Indeed, CCK was disinclined to talk in specific terms about any *particular* aspect of economic policy. His determination not to repeat his regrettable experience with the Shanghai capitalists in the 1930s, and his faith in the ability of senior policy makers like Li Kwoh-ting left the younger Chiang with a broad figurehead role in economic policy making. In a discussion with renowned Chinese-American economist John Fei, CCK commented: 'Please tell your economists that CK [referring to himself in the third person] is a layman in economics and made many mistakes during my lifetime. What I can only claim is a salvaging virtue of learning from my mistakes.' John C.H. Fei, 'The Taiwan Economy in the Seventies' in Shao-chuan Leng (ed.), *Chiang Ching-kuo's Leadership in the Development of the Republic of China on Taiwan, Vol. 3 of the Miller Center Series on Asian Political Leadership* (Lanham, Maryland: University Press of America, 1993), p. 86.

[104] For more detail on these two groups of technocrats, see chapters 4 and 5, sections two.

1988 to 1990) were the prime movers behind it. As we will see in subsequent chapters, these individuals simply had interests elsewhere; press and personal interviews reveal a distinct lack of concern with the long-term development of the securities sector.[106] As for Lee Teng-hui's part in securities reform, the key question is 'Why?' In and of itself, securities reform did not serve Li's personal agenda immediately after taking office – i.e. consolidating his position as RoC President and KMT Chairman – and consequently he made no direct mention of it.[107] Bank reform, by contrast, did serve Li's immediate ambitions, and predictably enough the new President intervened on this issue during the first half of 1988[108] (more detail on this fascinating episode in chapter 5, section four). In sum, within the KMT hierarchy the only likely agents of securities reform were the development technocrats.

Outside the KMT regime, however, it seems plausible that in the early 1980s representatives of Taiwan's middle class directly petitioned for securities liberalization. As our discussion in section three demonstrates, this social group had a strong objective interest in reform: increasing the size and scope of the Taiwan Stock Exchange would directly benefit the market's plethora of small, individual investors. But despite the objective interest in opening, we find little hard evidence of a declared or subjective interest in policy change. Even at temporal junctures in which we might expect small investors to increase their advocacy – e.g. the sharp downturn in the stock index of 1982-83 that accompanied the slump in the local economy and world recession – there was no direct outcry from the group.[109] This 'dog that didn't bark' is simple enough to explain: the island's small investors were organizationally dispersed and fragmented. This state of social affairs was in large measure a side-effect of the KMT's authoritarian rule, although it is probable that even in an open political environment Taiwan's small investors would have faced little incentive to organize.[110] Articulating the implicit link between middle

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[105] Yu-ming Shaw, *Dr Lee Teng-hui: President of the Republic of China* (Taipei: Government Information Office, Executive Yuan, 1990), esp. p. 7-8.

[106] In an interview with the author, Shirley Kuo gave long and largely unprompted descriptions of foreign exchange and bank reform in Taiwan during the late 1980s – more in subsequent chapters. The issue of securities opening was not even referred to in passing. Interview in Taipei with Professor Shirley Kuo, Minister Without Portfolio, RoC Cabinet, 4 December 1996. In several press interviews, Robert Chien appears oblivious not only to the securities reform initiatives being undertaken in his name within the Ministry of Finance and Securities Exchange Commission, but also to the increasingly perilous state of the stock market. See, e.g.: CENs staffwriter, 'Breakthroughs in Financial Management are Needed: Interview with Robert C. Chien, Minister of Finance' in *Financial and Investment Yearbook, RoC 1988* (Taipei: China Economic News Service, 1988). This wide-ranging interview, conducted in late 1987, is particularly intriguing: Chien talks about the importance of government bond issues to soak up excess liquidity in Taiwan at that time, and yet doesn't even consider the question of how these instruments will be sold and traded in local securities markets.

[107] Yu-kou Zhou, *Li Deng-hui de Yiqian Tian: 1988-92* [A Thousand Days of Lee Teng-hui: 1988-92] (Taipei: Maitian Chuban, 1993), esp. chp. 1-3.

[108] See e.g.: *China News* (10 May 1988), p. 4.

[109] Assessment based on a review of stock market reports in *Tianxia Zazhi* [Commonwealth Magazine] (various editions, 1982-83). Supplemented with interviews in Taipei, 1996 and 1999.

[110] Based, of course, on a Chicago School proposition that large groups with diluted interests face less incentive to lobby for policy change compared to small groups with concentrated interests. From: Roger G. Noll, 'Government Regulatory Behavior: A Multidisciplinary Survey and Synthesis' in Roger G. Noll (ed.), *Regulatory Policy and the Social Sciences* (Berkeley: University of California Press, 1985), p. 44.

class interests and securities opening was a task that was orchestrated from within the KMT regime itself.[111]

While external influences were not a factor in the early 1980s, it seems at least probable that business interests were involved in the latter phases of securities opening. As mentioned in section one of this chapter, the freeze on brokerage licenses became a major issue of contention between the Executive Yuan and the Legislative Yuan through 1987, and eventually Cabinet gave ground permitting the entry of new securities firms. Business interests may have had a hand in this series of events: we know that various corporate groups were big winners when new securities companies were allowed into the market after May 1988.[112] There is some reason to believe, however, that the legislative proceedings of 1987 were simply part of an ambit-claim strategy orchestrated by the Executive Yuan. To successfully maneuver the amended Securities Exchange Law through the legislature, the Executive Yuan deliberately left the question of new licenses in abeyance (in the knowledge that the Legislative Yuan would bauk at this omission and that some form of compromise would be necessary to get the bill passed). The final regulatory product was no more or less than had been intended at the outset.[113] Further, as will be shown in more depth later in the thesis, business advocacy was not a major factor in legislative politics at least until mid to late 1988. Even after this time, it is doubtful that it had a major impact on the substance of finance policy choice; at most, the business lobby in the Legislative Yuan was a negative, reactive voice.[114] In the final analysis, the initiative on securities reform remained in the hands of the KMT regime, and who else but the development technocrats had a cause to pursue in this policy area?

Conclusion

It has been the argument of this chapter that the process of securities reform on Taiwan through the 1980s and beyond was ultimately driven by the ideas and exploits of the development technocrats, and followed a pattern dictated by the long temporal spread of opportunities presented within the KMT regime. Securities reform initially arose as an ideational imperative

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111 See esp. government declarations and media comment in: *Zhongguo Shibao* [China Times] (5 July 1981), p. 6; *Zhongyang Ribao* [Central Daily News] (16 July 1983), p. 1; and *Zhongguo Shibao* [China Times] (26 July 1983), p. 1 – contain reports on the establishment of Fuh Hwa in 1980 and the launch of the first Securities Investment Trust Enterprise in 1983.

112 With six of the top ten firms on the island possessing a license by August. *Tianxia Zazhi* [Commonwealth Magazine] (1 August 1988), p. 95.

113 Comments in interviews in Taipei, 1996 and 1999. I am particularly grateful for a discussion regarding the politics of EY-LY relations with Mr Lin Huan, Coordination and Service Office for the APROC Program, Council for Economic Planning and Development, Executive Yuan, 26 March 1999. These interpretations correspond with the fact that new licenses had been on the securities reform agenda since the early 1980s – the Legislative Yuan had good cause to believe that it would be a part of the final package of statutory amendments. See e.g.: Li-teh Hsu, 'Dangqian Caizheng Gongzuo de Zhongdian' [Current Important Tasks in Finance – Sun Yet-sen memorial lecture] in Li-teh Hsu, *Xiandai Caizheng Zhengce Lunshuo* [Fiscal Policy] (Taipei: Ministry of Finance, 1984), esp. p. 61-63. Although contorted and opaque in parts, this speech is significant because of the audience: President Chiang Ching-kuo was present. To my knowledge, this represents the first occasion in which the detail of securities reform was publicly spelled out to CCK.

because the development technocrats came to see it as a precondition of technological upgrading on Taiwan. It became a practical reality – i.e. a distinguishable process – as party political 'windows of opportunity' opened up in 1980 and 1987. In a manner that compares starkly with forex reform and to a significant extent with bank liberalization, the temporal spread of party-political opportunities that faced the development technocrats was wide and discontinuous. The development technocrat's reform agenda got off the ground in 1980 because it was seen as an effective means of securing urban middle class support for the KMT in the face of growing competition from the opposition *dangwai*. Reform reached its apex and moved to the consolidation phase after 1987 because the systemic character of local securities markets at that time radically breached the ruling party's preference for a stable and controllable financial system. The pattern of securities opening on Taiwan was long and measured precisely because *these two policy windows opened almost eight years apart.*

The chapter was composed of four main parts. In part one we reviewed the process of securities policy reform. This section focused on the procedural effect of securities liberalization rather than the cause. In part two of the chapter we looked behind the outcomes detailed in part one and sought to analyze *why* it all happened. This section included an examination of the ideas and interests of the development technocrats – including 'policy heroes' Li Kwoh-ting and Hsu Li-teh. Part three of the chapter was dedicated to the policy windows that emerged within the KMT regime over the course of the 1980s. In this extended section of the chapter we examined how and why these windows opened when they did. Finally, in part four of the chapter we considered the ways and means in which our development technocrats capitalized on the respective opportunities, and looked at alternative reform agents. In the next chapter of the study I will investigate the process of foreign exchange reform which commenced in 1986 and concluded around three years later. The pattern of reform in this instance was fast, abrupt and managerial (i.e. not at all incremental); the contrast with the case of securities reform could not be greater. We will find, however, that once again a small group of technocrats was at the center of the process, and KMT politics was crucial to its ultimate outcome.

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[114] See discussion in chapter 5, section three.

-Chapter 4-
The great leap forward: foreign exchange liberalization, 1986-89

Introduction

For many years, the foreign exchange (forex) market in Taiwan and the reserve management practices of the island's central bank, the Central Bank of China (CBC), were one and the same. Despite the vital role played by the foreign exchange system in oiling the wheels of Taiwan's small, externally dependent economy, '[t]he central bank alone was authorized under exchange controls to hold foreign exchange and conduct foreign exchange transactions, and to designate commercial banks as agents. All foreign exchange transactions had to be conducted through the designated banks at the official exchange rate.'[1] In mid 1987, however, the floodgates were opened.[2] After nearly four decades of maintaining a tight monopoly on all foreign exchange transactions, on 15 July the CBC announced that the control system embodied in the Statute for the Administration of Foreign Exchange (SAFE) would be abandoned, and that henceforth all RoC citizens would be entitled to hold and trade foreign currency. The initiative was greeted with wild enthusiasm by Taiwan's emergent service sector, and created a furor as businesses and the general population strived to come to terms with the new regulatory regime. Banks were bombarded with questions from perplexed customers. Even the government was unsure what of it all meant. In the days immediately following the reform move, questions were raised by various government agencies about the continuing relevance of a multitude of commercial laws and regulations. The regulatory changes were not only radical, but chaotic as well.[3]

In chapter 3 of the thesis we saw how the theory of technocrat leadership applied to the case of securities reform. The process of change in that area of financial administration was remarkably slow and incremental, indicative of the wide spread of party political opportunities facing activist technocrats. In this case, those concerned were the 'development technocrats,' a loose grouping of state officials who looked to industry guru Li Kwoh-ting for direction and inspiration. In the present chapter we will be examining the case of foreign exchange reform. In many ways, this episode of financial opening was the direct opposite of the securities case. Forex reform was fast, concerted and, as the brief introductory comments given above suggest, almost totally unanticipated by major stakeholders. The pattern of change covered a period of just three or four years after 1986, and involved none of the experimental 'learning-by-doing' of the securities episode. But if we look behind the process of forex reform, we find that once

[1] Hang-sheng Cheng, 'Financial Policy and Reform in Taiwan, China' in Hang-sheng Cheng (ed.), *Financial Policy and Reform in Pacific Basin Countries* (Lexington: D.C. Heath and Company, 1986), p. 155.
[2] To paraphrase one foreign journalist's appraisal of the policy shift: *Far Eastern Economic Review* (23 July 1987), p. 52.
[3] Various points and observations from: *Jingji Ribao* [Economic Daily News] (16 July 1987), p. 1-2; and *Zhongguo Shibao* [China Times] (16 July 1987), p. 1-2.

again the initiative and energy for change was tied to a select group of concerned technocrats.[4] Foreign exchange liberalization initially got off the ground because the 'finance technocrats' – a tightly composed group of state officials who owed their allegiance to senior finance administrator Yu Kuo-hwa – became convinced some years prior to the late 1980s that the internal and external circumstances of Taiwan's economy rendered the old forex system obsolete. The story of when and how Yu's team of officials was able to act is part of a generalizable account of KMT politics. In chapter 1 of the thesis I argued that for technocrats ultimately to be successful with financial reform, two kinds of 'policy window' need to be open within their referent political party, a broad socio-political window and a narrow sectoral-strategy window.[5] In this chapter I will demonstrate that the pattern of foreign exchange reform in Taiwan was distinctly short and decisive *because these two policy windows opened almost simultaneously*. This temporal spread of opportunities was the inverse of that which we can observe over the course of securities opening. The variance in when and how respective technocrats were permitted to act explains the alternative processes of policy change.

Following the pattern established in chapter 3, the present chapter is composed of four main parts. In part one we review the process of foreign exchange reform. I include an account of the principal steps in the forex reform cycle, and give due attention to the institutional context. In part two of the chapter we look behind the outcomes detailed in part one and seek to analyze why it all happened. This section includes an examination of the character and ideas of Yu Kuo-hwa's finance technocrats, the enigmatic entrepreneurs of the forex reform story. Part three of the chapter is dedicated to the windows of opportunity that emerged within the KMT over the course of 1986. In this section we examine in some depth why and how these windows opened. Finally, part four of the chapter considers the response of the finance technocrats to the KMT policy windows described in part three. This section includes an examination of the micro-politics of forex reform.

1. The process of forex reform

While Taiwan's shift in foreign exchange policy of the late 1980s was similar in extent and direction to the reforms undertaken in securities and banking at that time, the *process* of forex policy change was in a league of its own (for a condensed overview, see Table 4.1). Forex

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[4] To recap the definition given earlier in the study: a technocrat is a state official who uses their claim to knowledge in some specialist area, or their ability to perform some specified function, to affirm their right to public office. From: Miguel A. Centeno and Particio Silva, 'The Politics of Expertise in Latin America: Introduction' in Miguel A. Centeno and Patricio Silva (eds.), *The Politics of Expertise in Latin America* (London: Macmillan Press, 1998), chp. 1. See also: Frank Fischer, *Technocracy and the Politics of Expertise* (Newbury Park: Sage Publications, 1990), chp. 1.

[5] It will be remembered from chapter 1 that the socio-political window is generated by a reconfiguration of, or challenge to, the ruling political party's social support base, and the sectoral-strategy window is created by any perceived failure of established financial policy to realize the party's sectoral goals. The notion of the policy window is borrowed from: Jeffrey T. Checkel, *Ideas and International Political Change: Soviet/Russian Behavior and the End of the Cold War* (New Haven: Yale University Press, 1997), esp. chp. 1

reform was sharp, distinct and discontinuous – spanning a total period of just over three years. Almost no time at all was allowed for the planning and execution of regulatory change, and there were few loose ends once the reform process was finally completed in mid to late 1989. Further, the decisiveness of the policy shift had few precedents within the field of RoC foreign exchange administration; the establishment and fine-tuning of the original SAFE was a slow and tedious affair spanning nearly two decades.

TABLE 4.1 Process of foreign exchange reform, 1986-89

Phase	*Period*	*Regulatory Initiative*
Takeoff	14 May 86	CBC commences current account reform. Announced July.
	Oct 1986	EY & MoF declare gold no longer subject to trade restrictions.
	12 Mar 87	CBC announces duo of new remittance regulations.
Development	27 Mar 87	CBC and EY announce major change to SAFE.
	Apr-Jun 87	CBC prepares for regulatory change – extremely rushed.
	16 Jun 87	Amended SAFE passes the LY. Reform rendered irreversible.
	9 Jul 87	EY passes reform package.
	12 Jul 87	CCK promulgates new SAFE.
Apex	15 Jul 87	New regulatory framework for forex officially launched.
Consolidation	1988	Period of forex policy review.
	Apr 89	Genuine float of NT$ launched.
	May 89	Supplementary investment regulations updated.
	Aug 89	Inter-bank foreign currency loan market established.

Notes: CBC is the Central Bank of China, EY is the Executive Yuan, MoF is the Ministry of Finance, SAFE is the Statute for the Administration of Foreign Exchange, LY is the Legislative Yuan, CCK is Chiang Ching-kuo and NT$ is the New Taiwan dollar.
Sources: Various. See: *Central Bank of China Annual Report* (Taipei: Central Bank of China, various issues); and *Zhonghua Minguo Zhongyang Yinhang zhi Zhidu yu Gongneng* (Taipei: Central Bank of China, 1991), esp. p. 98-115; or *Central Bank of China: System and Functions* [official trans.] (Taipei, Central Bank of China, 1996), esp. chp. 8. See also: *Far Eastern Economic Review* (various issues, 1986-87).

In chapter 3 of the thesis, I introduced data on the process of securities reform within the context of a four-phase progressive model. I utilize this framework in the present chapter as well. The four phases of forex liberalization covered the following junctures: the takeoff phase from May 1986 to March 1987, the development phase from March to June 1987, the apex of reform in July 1987, and the consolidation phase from July 1987 to August 1989. Prior to the takeoff phase – understood as the transitional period of forex reform – a general notion of 'restricted in principle' was the guiding standard of foreign exchange regulation in Taiwan. For almost 40 years following the retreat to Formosa, forex dealings were prohibited as a general rule, and exceptions made for only a small number of specified transactions (including movements of currency arising from exports, or imports of capital goods and production components). As we saw in chapter 1 of the thesis, these principals and provisions were incorporated into a strict foreign exchange clearing system and a fixed exchange rate mechanism, and were eventually codified in the 1970 SAFE. Over the years, the SAFE framework underwent a series of minor modifications, including the introduction of a managed float of the NT dollar in December 1978 and the establishment of the Taipei offshore banking market in April 1984. While heralded as major reforms at the time, all of these adjustments were merely variations on the theme of restriction.[6]

As 1986 unfolded, however, the traditional policy stance rapidly changed. The adjustment in official thinking on forex administration was marked by three hastily conceived reform moves. The first of these transitional initiatives came in early to mid 1986. After receiving the go-ahead from the Executive Yuan on 14 May, the CBC set about redesigning the regulatory provisions for trade. Two months later, the Central Bank announced the Regulations Governing Foreign Exchange Reporting in Respect of Exports and Imports, a move which substantially relaxed current account transactions.[7] The second transitional initiative had implications for the capital account. In October of 1986, the Executive Yuan and Ministry of Finance announced that gold and silver would no longer be regarded as so-called 'general mobilization goods' (*guojia zongdongyuan wuzi*) and therefore subject to a wholesale ban on trading. As of 1 November 1986, designated banks and jewelry stores were given the authority to conduct over-the-counter trade in precious metals.[8] In theory, this initiative provided a means by which RoC citizens could import and export investment funds. Finally, on 12 March 1987, the CBC introduced the Regulations Governing the Review of Non-Governmental Inward Remittance and the Regulations Governing Payments Resulting from Intangible Trade Transactions. This regulatory initiative (or rather, duo of initiatives) was something of a mixed bag: it partially reversed the earlier flirtation with decontrolling the current account, but removed limitations on the amount of outgoing foreign exchange that could be settled in respect of intangible trade. For the first time in RoC history, payments such as outward-bound company royalties were no longer subject to quantitative restrictions.[9]

Just two weeks after this somewhat ambiguous regulatory move, the forex reform process suddenly became more strategic and concerted – the start of the development phase of foreign exchange reform. On 27 March, the Central Bank and the Executive Yuan announced that they

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[6] From: Lawrence S. Liu, 'Brave New World of Financial Reform in Taiwan, The Republic of China – Three Waves of Internationalization and Beyond' in *Chinese Yearbook of International Law and Affairs* Vol. 8 (1988-89), p. 136-140; *Far Eastern Economic Review* (11 May 1979), p. 40-41; and Kuo-Shu Liang and Ching-Ing Liang, 'Challenges in the 1990s for Banking and Financial Markets in Taiwan' in *Journal of Asian Economics* Vol. 2, No. 2 (1991), p. 406.

[7] Philip Liu, 'Mounting Forex Reserves Prompt Rethinking of Economic Strategy' in *Financial and Investment Yearbook, RoC 1987* (Taipei: China Economic News Service, 1987).

[8] Willis Ke, 'Strength of NT Dollar Bringing Forex Banks to Their Knees' in *Financial and Investment Yearbook, RoC 1987* (Taipei: Central Economic News Service, 1987), p. 35.

[9] *Zhonghua Minguo Zhongyang Yinhang zhi Zhidu yu Gongneng* (Taipei: Central Bank of China, 1991), p. 103-104; or *Central Bank of China: System and Functions* [official trans.] (Taipei, Central Bank of China, 1996), p. 133-134. See also: *Far Eastern Economic Review* (26 March 1987), p. 74.

would be lifting all remaining current account restrictions, as well as most controls on the capital account. Described as a 'deathbed conversion to foreign exchange liberalization' by one foreign banker, the announcement took most people in finance circles by surprise.[10] In the weeks following the decision to lift forex controls, the CBC embarked upon a lightening program of preparation. It was anticipated that the Legislative Yuan would pass the Central Bank's amendment bill sometime before the end of June, and this would allow controls to be lifted around the start of July. The extremely short period of policy development – around 12 weeks from late March to June – had few precedents in Taiwan's administrative history. Central Bank officials were working around the clock to meet the deadline.[11] Indicative of the degree of haste (indeed, panic) involved, there was considerable public disagreement among finance officials on the details of reform. During one particularly embarrassing press conference, a Central Bank representative commented that the reform measures would apply uniformly to 'all cross-border flows.' Soon after, a CBC colleague remarked that capital account deregulation would only apply to personal remittances such as 'small amounts of money for students studying abroad.'[12] This was not the stuff of patient and meticulous policy change.

Against this disconcerting background, on 16 June the Legislative Yuan passed the CBC's reform bill. The passage of the new SAFE[13] was remarkably speedy. At the same time as the forex bill was being considered, the Legislative Yuan also had its hands full with the abolition of martial law; the fact that the foreign exchange reform bill only took three months to traverse the legislature was surprising indeed. But there was a sting in the tail of this efficiency. The legislators had added a clause to the amended SAFE obliging the Executive Yuan to submit any future proposal to reintroduce forex controls to the Legislative Yuan.[14] The financial authorities were taken aback by the Legislative Yuan's mischievous addition. Knowing that lifting controls might well be irreversible, the CBC and the Executive Yuan moved quickly to finalize the reform plan. On 9 July, Cabinet passed the reform package and sent the new law off to President Chiang Ching-Kuo for promulgation. CCK performed his presidential duty on 12 July, and three days later the reform package was implemented.[15]

The introduction of the amended Statute for the Administration of Foreign Exchange signaled the apex of forex reform in the RoC. The final product was not, it must be said, as liberal as some would have liked. Shortly before the implementation of the SAFE reform package, the Council for Economic Planning and Development (CEPD) drafted a plan for the

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[10] *Jingji Ribao* [Economic Daily News], (28 March 1987), p. 1; and *Far Eastern Economic Review* (9 April 1987), p. 119-121.

[11] *Far Eastern Economic Review* (9 April 1987), p. 120.

[12] *Jingji Ribao* [Economic Daily News] (27 June 1987), p. 1.

[13] The changes actually amounted to little more than the addition of a simple moratorium clause giving the CBC the power to bypass forex controls. See: *Guanli Waihui Tiaoli* [Statute for the Administration of Foreign Exchange] (Taipei: Central Bank of China, 1987), art. 26-1

[14] *China News* (17 June 1987), p. 8.

[15] *China Post* (15 July 1987), p. 12.

complete internationalization of the NT dollar. Under the CEPD proposal, foreigners were to be afforded equal rights with RoC citizens to hold and trade the local currency.[16] While the CEPD model was ultimately rejected, the amended SAFE was still far more accommodating than its predecessor. Upon implementing the new regulatory scheme, the Central Bank presented the major areas of reform. These included: trade of foreign currency in spot markets, forward transactions, non-governmental inward remittances, non-governmental outward remittances, the establishment and operation of foreign currency cashiers, the administration of foreign credit cards, the management of foreign debt incurred by private enterprises, and the administration of foreign currency deposits at banks and other financial institutions. In total, these changes gave RoC citizens the unprecedented right to hold and freely exchange *all* trade-related funds and *most* cross-border investment funds. They provided for the construction of a completely new set of markets, institutions and property rights on Taiwan.[17]

In the two years or so after the launch of the new forex system, the financial authorities introduced a series of follow-up reforms to consolidate the regime. Following a period of policy review over 1988, in early to mid 1989 a triad of regulatory changes was introduced in quick succession. The first of these changes was the introduction of a genuine float of the exchange rate in April. Since the late 1970s, the CBC had experimented with a number of 'managed float' systems. All of these mechanisms were little more than a rearrangement of the Central Bank's original administrative prerogative. Once RoC citizens had obtained the right to own and trade foreign currency, however, this monopoly was no longer practicable. After April 1989, supply and demand in the new interbank and bank-customer markets for foreign exchange largely determined the forex rate.[18] In May, the government sought to update a number of the supplementary regulations for inward and outward investment. Three key statutes administered by the Ministry of Economic Affairs – the Regulations Governing the Handling of Outward Investment and Technical Cooperation, the Statute for Investment by Foreign Nationals, and the Statute for Investment by Overseas Chinese – were reviewed to harmonize their operation with the new SAFE. Major changes included the adoption of negative vetting lists, and an *ex post facto* assessment procedure for most categories of cross-border investment.[19] Finally, in

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[16] *Wo Guo Guanli Waihui Tiaoli Quanpan Xiuzheng Yanjiu Baogao, #2001* [Research Report Number 2001 on the Complete Revision of the RoC Statute for the Administration of Foreign Exchange] (Taipei: Council for Economic Planning and Development, Executive Yuan, 1987).

[17] See esp.: Lawrence S. Liu, 'Republic of China's Deregulation of Foreign Exchange Control' in *Chinese Yearbook of International Law and Affairs* Vol. 6 (1986-87), p. 300-305; and *Jingji Ribao* [Economic Daily News] (16 July 1987), p. 2. This issue of JR includes a number of good articles on the new SAFE, including analysis of economic and policy aspects.

[18] *Financial Market Integration in Chinese Taipei* (Taipei: Bureau of Monetary Affairs, Ministry of Finance, 1995), p. 71.

[19] *Dui Wai Touzi ji Keji Hezuo Shenhe Chuli Banfa* [Regulations Governing the Handling of Outward Investment and Outward Technical Cooperation Projects] (Taipei: Industrial Development and Investment Center, Ministry of Economic Affairs, 1989); *Wairen Touzi Tiaoli* [Statute for Investment by Foreign Nationals] (Taipei: Industrial Development and Investment Center, Ministry of Economic Affairs, 1989); and *Huaqiao Huiguo Touzi Tiaoli* [Statute for Investment by Overseas Chinese] (Taipei: Industrial Development and Investment Center, Ministry of Economic Affairs, 1989).

August, the financial authorities moved to create a genuine interbank foreign currency loan market in Taiwan. Established as a separate entity from the Taipei offshore banking market (briefly mentioned above), the new loan facility allowed banks in Taiwan to independently take a long position on foreign currency for the first time. The new market was launched with seed money from the Central Bank and offered borrowing and lending in all major currencies.[20]

2. The finance technocrats and the rationale for change

It is apparent from the regulatory data reviewed above that the process of foreign exchange reform in Taiwan during the late 1980s was extraordinarily fast and energetic. The phasal sequence of policy change progressed like a Hong Kong action film; the whole course of activity took only three years to complete and encompassed a sharp, dramatic climax. The contrast with the process of securities reform that we reviewed in chapter 3 of the thesis could not be starker. That reform process was painfully slow and incremental, spanning a total period of over a decade. The difference in the two cases demonstrates quite clearly that there is no single process of financial policy change intrinsic to Taiwan – that is to say, it cannot be suggested that forex opening followed some kind of inherent 'Taiwanese path.' Further, it must be noted that a fast and furious pattern of foreign exchange liberalization is not typical of most forex reform episodes. Generally speaking, the reverse is true. For most countries, forex opening has involved considerable muddling through – an extreme example being set by Taiwan's regional neighbors Japan and Korea.[21] In terms of process, the Taiwan case probably sits closer to some of the more dramatic examples of forex opening such as Chile or New Zealand.[22]

So what explains the process of foreign exchange liberalization in Taiwan? Certainly, aspects of the reform experience can be illustrated with the established theoretical tools we saw earlier in the thesis.[23] However, none of these competing approaches gives a satisfactory account of why the forex reform process took the form of a sharp spike of activity rather than some alternative pattern. The theories are particularly poor in explaining why the

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[20] Kuo-shu Liang, 'The Banking System and Financial Reform in Taiwan' in *Industry of Free China* Vol. 78, No. 3 (September 1992), p. 36.

[21] See respectively: Frances McCall Rosenbluth, *Financial Politics in Contemporary Japan* (Ithaca: Cornell University Press 1989), chp. 3; and Stephan Haggard and Sylvia Maxfield, 'The Political Economy of Financial Internationalization in the Developing World' in *International Organization*, Vol. 50, No. 1 (Winter 1996).

[22] See respectively: Laura Hastings, 'Regulatory Revenge: The Politics of Free Market Financial Reforms in Chile' in Stephan Haggard, Chung H. Lee and Sylvia Maxfield (eds.), *The Politics of Finance in Developing Countries* (Ithaca: Cornell University Press, 1993), chp. 7; and Suiwah Leung, 'Financial Liberalization in Australia and New Zealand' in Sylvia Ostry (ed.), *Authority and Academic Scribblers* (San Francisco: ICS Press, 1991), chp. 8.

[23] The theories include: the market-driven approach, statist analysis, pluralism and the foreign pressures model. See chapter 1, part two. Leading examples of these four theories include, respectively: Richard O'Brien, *Global Financial Integration: The End of Geography* (London: Pinter Publishers, 1992); Louis W. Pauly, *Opening Financial Markets: Banking Politics on the Pacific Rim* (Ithaca: Cornell University Press, 1988); Rosenbluth, *Financial Politics in Contemporary Japan*, fn. 21; and Eric Helleiner, *States*

implementation of the amended SAFE in July 1987 (i.e. the apex of reform) was such a shock to everyone concerned.[24] It is a broad theme of this thesis that the liberalization of finance is generally linked to the leadership efforts of elite technocrats. In the first instance, liberalization arises as a conceptual strategy because members of this group decide to take-up the reform agenda and run with it. In this context we will see below that the initial motive for forex reform owed much to the experience and thinking of the 'finance technocrats' – a small circle of officials loyal to finance expert and long-term policy practitioner Yu Kuo-hwa. Yu and his supporters were driven by a firm conviction that the established forex system had outlived its usefulness. By the early 1980s, they believed that Taiwan's economy had surpassed the need for a restrictive system of forex controls, and considered that the system's retention was likely to produce perverse effects. This conviction had evolved from their combined experience as senior administrators over the 1970s and early 1980s, and was well entrenched in their outlook on policy matters by the start of forex reform in 1986.

The story of when and how Yu and his cohort of technocratic insiders were able to act is one of KMT political preferences and strategies. In chapter 1 of the thesis I argued that for elite technocrats to be ultimately successful with financial reform, two kinds of policy window need to be open within their referent political party: a broad socio-political window and a narrow sectoral-strategy window.[25] I demonstrate below that the pattern of forex reform in Taiwan evolved the way it did simply because, insofar as this subsector of finance was concerned, *these two policy windows opened almost simultaneously.* In a manner that contrasts strongly with securities liberalization, the temporal distribution of party political opportunities facing the relevant technocrats was extremely narrow – indeed so narrow that in many respects they overlapped. Early 1986, the finance technocrat's agenda for forex policy change was assured the attention of the KMT regime as it became an effective means of shoring up party support among small to medium sized manufacturers – a category of traditional party support which was suffering badly from a dramatic rise in the NT dollar exchange rate (socio-political window opens). Very soon afterwards, the technocrats' reform program received full backing from the KMT because the established foreign exchange system was inadvertently generating an explosion in the domestic money supply – evoking the threat of inflation and therefore a breach of the ruling party's preference for a stable and controllable financial sector (sectoral-strategy window opens). The negligible period of time between these two windows meant that Yu and his cohort of reformers were able to make foreign exchange liberalization an expeditious course of action.

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and the Reemergence of Global Finance: From Bretton Woods to the 1990s (Ithaca: Cornell University Press, 1994).

[24] See press comment in: *Jingji Ribao* [Economic Daily News] (16 July 1987), p. 1-2 & editorial; and *Zhongguo Shibao* [China Times] (16 July 1987), p. 1-2. The sense of surprise is palpable here. The contrast with equivalent press commentary coinciding with the introduction of the new Securities Exchange Law is stark indeed.

[25] From chapter 1, section three.

We saw in chapter 3 that the technocrats initially involved in guiding the process of securities policy change were strongly influenced by the development agenda of technology guru Li Kwoh-ting. These elite economic policymakers – dubbed the 'development technocrats' or the 'KT Faction' by outsiders – were primarily interested in Taiwan's transition from low to high technology manufacturing. For them, securities reform was a by-product of their concerns with the evolving nature of Taiwan's real economy. The technocrats behind the process of foreign exchange liberalization, however, were far more interested in the operation of the financial sector as an independent entity. This group of technocrats took their cue on financial policy matters from senior economics administrator Yu Kuo-hwa, and came to be known in policy circles as the 'Yu Faction' (*Yu Xi*) or simply the 'finance technocrats' (*caijing guanliao*).[26] While similar to KT Li's band of technocrats in a broad systemic sense (see arguments in chapter 2, section three), the finance technocrats differed from Li's followers in some important respects. They were typically technocrats with: (1) an academic background in economics rather than engineering, law, science or the humanities; (2) extended, but not exclusive experience as an official in the Central Bank of China; and (3) considerable professional experience at one of Taiwan's state-owned banks, typically at senior levels, but only rarely at any other state-owned enterprise. As a rule, Yu's technocrats were keen to portray themselves as finance specialists first and political functionaries second – perhaps the closest thing in Taiwan to the disinterested 'econocrat' referred to in various academic studies of policy reform in Latin American and Eastern Europe.[27]

Reflecting this desire to rise above politics, the finance technocrats fostered an elitist character and kept the internal dynamics of the group out of the public eye. The most glaring example of this exclusivity was the Freemason-like influence Yu and his followers maintained over appointments within the local finance industry. Throughout the 1970s and much of the 1980s, the Yu Faction was directly involved in virtually every senior appointment in RoC banking. The most prominent bankers of the day – such as Ronald Ho, C.D. Wang, Y.D. Hsu, L.S. Lin and Sun I-shuan – were all strongly indebted to Yu and his cohort of technocrats for their impressive career paths. Likewise, an increasing number of the up and coming finance administrators of that era – rising stars like Liang Kuo-shu, Paul Chiu, Shirley Kuo, Samuel Shieh and Yu Chen – owed their career successes to Yu Kuo-hwa or the friends thereof.[28] The

[26] Jun Wang, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [Finance Master: Yu Kuo-hwa's Life and Travels] (Taipei: Sunbright Publishing Company, 1999), p. 248.

[27] The ideal type image is of an academic economist who reluctantly gets involved in the policy process for fear of 'bad' policy being implemented if he doesn't. For a discussion of the intellectual heritage of this ideal type, see: Miguel A. Centeno, 'The Politics of Knowledge: Hayek and Technocracy' in Miguel A. Centeno and Particio Silva (eds.), *The Politics of Expertise in Latin America* (London: MacMillan Press, 1998), chp. 36.

[28] The complete list of those that received the Yu Faction's blessing can be found in: Wang, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [Finance Master: Yu Kuo-hwa's Life and Travels], fn. 26, esp. section 2. Supplemented with English language material in: *Financial & Investment Yearbook, RoC* (Taipei: China Economic News Service, various issues, 1980s), see esp. bibliographic information in the back of this publication.

elitist character of the finance technocrats was further reinforced by the highly selective relationships the group maintained with Taiwan's community of academic economists. The Yu clan relied heavily on advice from just a handful of senior lecturers at National Chengchi University (the most important among them Professor Zhang Zi-kai), individuals who were often ex-CBC officials themselves. Only rarely did the group seek assistance from, or openly engage in public debate with, high profile economists like T.S. Tsiang and T.C. Liu from National Taiwan University. The advice of Professors Tsiang and Liu, like many of their colleagues in Taiwan at the time, was regarded as simply too 'theoretical' to be of any use in the real world of monetary administration.[29]

During the forex reform process of the late 1980s the core of the finance technocrats consisted of Yu Kuo-hwa (Yu Guo-hua) himself, Robert Chien and Chang Chi-cheng. With Yu at the head of the group, these three elite technocrats were almost entirely responsible for the content of forex reform. At least initially, however, Yu Kuo-hwa's educational background did not prepare him for a position as a finance administrator. At Tsinghua (*Qinghua*) University in Peking during the 1930s, Yu had studied political science with the intention of taking up a defense-related position in the Nationalist government. A decade of experience as Chiang Kai-shek's personnel assistant, however, convinced the young civil servant that he needed a more specialized education. In the 1940s, Yu attended Harvard and the London School of Economics with the express intention of developing an expertise in finance. After three years as a research student at both institutions, Yu attained senior positions as an RoC representative in the newly formed World Bank and International Monetary Fund. In 1955, upon Chiang Kai-shek's request, Yu returned to the RoC – by then, an outpost confined to the island of Taiwan – and took up a position as President of the Central Trust of China (a government trust bank with wide administrative duties at that time). Thereafter, Yu's career went from strength to strength: Director of the China Development Corporation and Chair of the Bank of China, 1961-67; Minister of Finance, 1967-69; governor of the Central Bank of China, 1969-84; Chair of the Council for Economic Planning and Development, 1977-84; and finally RoC Premier, 1984-89. During these later appointments, Yu also became a member of the Central Standing Committee of the KMT (1979) and a senior advisor to President Chiang Ching-kuo. In the ensuing years, Yu's personal influence in economic policy circles became increasingly strong and entrenched. Few policy changes of that period saw the light of day without his consent, and a good number, like forex reform, were directly his own initiative.[30]

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[29] See, for example, career review article on T.S. Tsiang in *Tianxia Zazhi* [Commonwealth Magazine] (1 February 1986), p. 40-49. Augmented with various interviews in Taipei 1996 & 1999; esp. interviews with Paul C.D. Lei, Senior Economist, Department of Foreign Exchange, Central Bank of China, 28 August 1996, and Dr Yen Tzung-Da, Assistant Director General, Economic Research Department, Central Bank of China, 3 June 1996.

[30] Wang, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [Finance Master: Yu Kuo-hwa's Life and Travels], fn. 26, esp. section 1. Supplemented with English language material from: *Republic of China Yearbook, 1996* (Taipei: Government Information Office, 1996), p. 592-593.

Among Yu's band of technocrats, his most trusted ally was undoubtedly Robert Chien *(Qian Chun)*. The two first met in the mid 1950s while Chien was working in the Ministry of Education, temporarily on secondment to China Trust as part of a personnel-sharing arrangement. Over the next 30 years, they were virtually inseparable as they rapidly rose to senior positions within the RoC state. Referring to each other endearingly as 'comrades in arms' (*zhanyou*), Yu and Chien formed a formidable team as master and apprentice in the art of finance administration.[31] Chien's educational background ensured that, like Yu, he was hot property in Taiwan during the impoverished years of the 1950s: he studied undergraduate economics at National Taiwan University in the late 1940s, and earned a Masters in economics from the University of Minnesota in 1957. After a brief period of academic work,[32] in 1963 Chien took up a post as Director of Research at the Bank of China. Five years later, he was made Executive Secretary of an Executive Yuan special committee on tax reform, before being poached by Yu Kuo-hwa in 1970 to commence a decade and a half of work in the Central Bank. His positions in the Bank included: Secretariat Director, 1970-73; General Manager of the Banking Department, 1973-77; and Deputy Governor, 1972-85. In 1985, Chien left the Central Bank to become Minister of Finance – the pinnacle of his career. Thereafter, he held a series of largely ceremonial positions in Taiwan's banking industry, and was appointed a member of the Central Committee of the KMT.[33]

Chang Chi-cheng's (*Zhang Ji-zheng*) career path did not place him as close to Yu Kuo-hwa as Robert Chien, and to some degree the core of the finance technocrats functioned as 'two plus one.' Media reports typically portrayed Chang as something of a loner in his professional life.[34] Probably the most important factor that separated Chang from Yu and Chien was his academic background; initially, Chang seemed more likely to be associated with KT Li's band of technocrats. Over the 1940s, he earned a Masters of Science from Tongji University in Shanghai, and a Ph.D. in civil engineering from Cornell. Upon returning to the RoC, Chang held a series of academic positions culminating in a chair at National Taiwan University. With a well-established academic reputation behind him, in the late 1950s Chang commenced a career in government. Over the next decade and a half, he tried his hand at a mixed bag of senior appointments before developing an interest in finance. His career highlights included: Vice Minister, Ministry of Economic Affairs, 1965-69; Minister of Communications, 1969-71; and Chair of the Economic Planning Committee, Executive Yuan, 1971-76. In 1978, Chang

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[31] Wang, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [Finance Master: Yu Kuo-hwa's Life and Travels], fn. 26, p. 253-254.

[32] During which time he co-authored two works of note. Both ran into multiple editions and printings, and one became a standard local textbook in second-year money and banking courses at universities around Taiwan. See: Xian-zhong He and Robert C. Chien, *Chuxu Touzi yu Zhengquan* 2nd ed. [Savings, Investment and Securities] (Taipei: Taiwan Lianhe Chuban, 1964); and De-le Qiang, Shao-rong Li, Robert C. Chien, and L.V. Chandler, *Huobi Yinhang Xue* 6th ed. [Money and Banking] (Taipei: Shangfu Chuban, 1972).

[33] *Zhonghua Minguo Mingrenlu, Minguo 88 Nian* [Who's Who in the Republic of China, 1999] (Taipei: Central News Agency, 1999), p. 264; and *Republic of China Yearbook, 1996*, fn. 30, p. 465.

was appointed Minister of Finance (which he held until 1981), and in the ensuing years his relationship with Yu Kuo-hwa and the finance policy community gradually solidified. This period included his time as governor of the Central Bank (1984-89), as well as a number of appointments in the banking industry.[35] Over the 1980s, Chang also rose through the ranks of the KMT, becoming a National Advisor to the President in the mid 1980s and a member of the Party Central Committee later in the decade.[36]

On the face of it, the Yu Faction was not the obvious group of technocrats to lead the way in foreign exchange liberalization. On most policy matters, observers considered Yu and his entourage highly conservative. Press comments on the role of Yu Kuo-hwa in the various liberalization initiatives of the late 1980s typically portray him as an arch reactionary rather than an architect of reform. One foreign journalist remarked that: 'Yu...stoutly resisted calls for faster action on trade and financial liberalization, until the weight of international and domestic pressure overwhelmed the former central bank governor's innate conservatism.'[37] Some of this reputation was a natural function of the group's traditional policy concerns – central bankers everywhere tend to be seen as guardians of the status quo[38] – and it is probably true that Yu, Chien and Chang had grown accustomed to managing the economy with dirigiste policy tools. This said, much of the finance technocrats' conservative reputation was attributable to a misinterpretation of their motives and operational context. Yu's band of technocrats were in fact political pragmatists rather than policy conservatives: they were not opposed to financial reform *per se*, merely to reform measures which they knew the KMT regime would never be able to accept. And regarding foreign exchange reform, that included just about anything more than modest tinkering. When the Yu Faction poured cold water on demands for financial policy reform – as they did on a number of occasions before the late 1980s[39] – they were merely relaying the party line. Privately and on a professional level, they knew only too well that the financial system in Taiwan had to change, and nowhere was this more apparent than in the area of forex administration.

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[34] *Tianxia Zazhi* [Commonwealth Magazine] (1 May 1989), p. 86.

[35] It also included an intermittent return to academic studies (for the purposes of honing his finance credentials), and the publication of a number of finance-related articles. See for example: Chi-cheng Chang, 'Financial Liberalization in the Republic of China' in S.G. Rhee and R.P. Chang (eds.), *Pacific-Basin Capital Markets Research, Volume II* (Amsterdam: Elsevier Science Publishers B.V., 1990).

[36] Bibliographic information from: *Gendai Chugoku Jinmei Jiten 1991 Nenban* [Who's Who of Contemporary China, 1991] (Tokyo: Kazankai, 1991), p. 2048. Augmented with interview material, esp. interview in Taipei with Professor Cheng You-ping, Associate Professor, Department of Public Administration, National Chung-hsing University, 26 March 1999.

[37] *Far Eastern Economic Review* (23 July 1987), p. 52.

[38] See for example: Arthur F. Burns, *The Anguish of Central Banking* (Washington: Per Jacobsson Foundation, 1979); Eugenia F. Toma and Mark Toma (eds.), *Central Bankers, Bureaucratic Incentives and Monetary Policy* (Boston: Kluwer Academic Publishers, 1986); and Martin Marcussen, *Central Bankers, The Ideational Life-Cycle and the Social Construction of the EMU* (San Domenico: European University Institute, 1998).

[39] For a particularly zealous example regarding bank privatization, see personal interview with Yu Kuo-hwa in Diane Ying (ed.), *Juecezhe* [Decision Makers] (Taipei: Commonwealth Publishing Co., 1983), esp. p. 23-26.

The truth of the Yu Faction's political pragmatism has only recently come to light. Yu, Chien and Chang's public pronouncements on foreign exchange policy during much of the 1980s seem to indicate that they resisted regulatory change well into the takeoff phase of reform in 1986.[40] However, in Wang Jun's revealing biography of Yu Kuo-hwa's life and career, it is apparent that Yu had decided very early on that Taiwan's original forex system was living on borrowed time. According to Wang's account, the Central Bank governor believed that in terms of economic efficiency and policy efficacy, Taiwan had actually outgrown the old forex regime by the end of the 1970s. Yu recalls that around 1968-69, the RoC's trade position shifted from deficit to surplus, and by the end of the 1970s the Central Bank had accumulated a healthy stock of foreign reserves. This meant that in principle at least, the country no longer needed comprehensive exchange controls and that their retention was increasingly a threat to monetary stability and an unwanted burden on the Central Bank of China (more on the technical aspects of this issue in the next section of the chapter). The experience of 1974 underlined this new reality when loose monetary conditions combined with a spike in oil prices to produce an annual inflation rate in excess of 40% – a level not seen since the late 1940s. Although skillfully handled at the time, the price spike of 1974 was a shock to Yu and the rest of the finance technocrats, and a sober warning of what could go wrong with the established forex system. The introduction of the managed float of the NT dollar in 1979 (and also, to some degree, the interbank money market in 1976) provided a short-term means of offsetting the pressures involved, but was only ever a partial solution. It offered no insulation whatsoever against the second oil shock of 1979-81 – a fact not lost on Yu as he and others struggled to manage the stagflation of the early 1980s. Indeed, in a sense the experiment with a managed float was probably worse than no adjustment in policy at all: the initiative engendered expectations of future forex reform, and encouraged discontentment among the commercial sector with the established system.[41]

Yu's early private analysis of the state of Taiwan's forex system dovetailed smoothly with his public analysis of the international economy in the late 1970s and early 80s. In Yu's description of the international economic system at this time he emphasized that the basic assumptions and institutions of the post-War boom – e.g. stable energy prices, decreasing trade protection, fixed exchange rates, the collaborative adjustment of fiscal and monetary policy, etc. – could no longer be relied upon. The new world economy was recession and inflation prone,

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[40] For Robert Chien and Chang Chi-cheng, see *Far Eastern Economic Review* (3 October 1985), p. 67; and for Yu Kuo-hwa, see personal interview in *Tianxia Zazhi* [Commonwealth Magazine] (1 June 1986), esp. p. 25-26.

[41] The points raised here are a condensed summary of Yu Kuo-hwa's thinking on forex matters over the 1970s and early 1980s as outlined in: Wang, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [Finance Master: Yu Kuo-hwa's Life and Travels], fn. 26, esp. p. 237-238, 244, 256-257, 268-276, 323-325, 358-360, 378-385 & 455-461. Supplemented with various interviews in Taipei, 1996 & 1999. See also: interview with Yu Kuo-hwa in Ying (ed.), *Juecezhe* [Decision Makers], fn. 39; and Xin-rong Xue, *Bianju Zhong de Yuejin: Yu Guo-hua de Zhengyuan Wunian* [In the Midst of Critical Change: The Five Year Cabinet of Yu Kuo-hwa] (Taipei: Zhengzhong Shuju, 1996), chp. 4 and 5.

and the short to medium term outlook for growth very poor. Yu stressed on numerous public occasions as governor of the Central Bank of China and Chair of the Council for Economic Planning and Development that in the context of this pervasive uncertainty, domestic policy 'flexibility,' 'discipline' and 'self reliance' were paramount. While these speeches and presentations were often long on rhetoric and short on detail, they leave little doubt that Yu was aware of the fact that Taiwan had to adapt to a new, riskier international environment.[42] When Yu was appointed Premier of the RoC cabinet in mid 1984, he incorporated this realization into his program for 'liberalization, internationalization and systemization' (*ziyouhua*, *guojihua* and *zhiduhua*). Many commentators were cynical about this policy agenda for it was again long on rhetoric but short on actual policy prescriptions. Invariably, however, 'pushing forward foreign exchange liberalization' (*tuidong waihui ziyouhua*) received a mentioned in all the associated planning documents and position papers. Although Yu was very tight-lipped about the particulars, he undeniably saw forex reform at the forefront of Taiwan's external adjustment process.[43]

It is apparent that privately at least, Yu Kuo-hwa had long appreciated the need to update Taiwan's foreign exchange system. But even if we accept that Yu and his followers held such views, what evidence do we have that their public reticence on forex reform was a reflection of KMT preferences rather than their own? In addition to the material we will see in the next section of this chapter, three interrelated points are worthy of mention up front. Firstly, we know for certain that the reticence exhibited by Yu and his entourage regarding forex reform was in large measure a part of a *conscious strategy of concealment*. In an interview with Professor Shirley Kuo, deputy governor of the Central Bank of China while both Yu Kuo-hwa and Chang Chi-cheng were governor, the senior stateswomen commented: '...[I]n my opinion the way the government [pursued forex reform] was very intentional....The level of intention involved was not seen by most people as we wanted to keep our aims quiet. Once you say a policy will be changed, you will meet obstacles, expectations and side effects which will undermine your efforts.'[44] These comments confirm that the finance technocrats' private rationale for forex reform cannot be explained away as a passing opinion, or an *ex post facto* rationalization: it was widely shared and deliberately disguised.

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[42] See for example: Kuo-hwa Yu, 'RoC Economic Development in the 80s' in *Industry of Free China* Vol. 53, No. 4 (April 1980); Kuo-hwa Yu, 'New Challenges to Our Economy' in *Industry of Free China* Vol. 54, No. 4 (October 1980); Kuo-hwa Yu, 'Dangqian Jingji Qingshi yu Zhanwang' [Current Economic Situation and Prospects] in *Ziyou Zhongguo zhi Gongye* [Industry of Free China] Vol. 59, No. 2 (February 1983); and Kuo-hwa Yu, 'Joint Efforts for Narrowing the RoC-USA Trade Gap' in *Industry of Free China* Vol. 60, No. 6 (December 1983).

[43] See: Yau-tung Chao, 'Liberalization, Internationalization and Systemization: New Currents in Taiwan's Economic Development' in *Industry of Free China* Vol. 68, No. 3 (March 1985); CEPD, 'Mingguo 74 Nian Taiwan Jingji Jianshe Jihua' [Taiwan's Economic Development Plan for 1985] in *Ziyou Zhongguo zhi Gongye* [Industry of Free China] Vol. 63, No. 2 (February 1985); and *Asian Wall Street Journal* (5 November 1984), p. 3, includes personal interview with Yu Kuo-hwa.

[44] Interview in Taipei with Professor Shirley Kuo, Minister Without Portfolio, RoC Cabinet, 4 December 1996.

Secondly, Yu Kuo-hwa's finance team was in a better position than most technocrats to understand the limited scope within the ruling party for forex policy change. By the mid 1970s, Yu had established a close association with Chiang Ching-kuo, and discussed the full range of state issues with the Premier and later President. This relationship became stronger still as CCK's health declined through the early to mid 1980s, and when Yu became Premier in 1984.[45] Chang Chi-cheng's father Zhang Qun was a member of the KMT's aging strata of party seniors (the so-called *zhengdang dalao*), a group that retained a level of status and authority in the ruling party even though many of its number were senile or bed-ridden.[46] As we saw in chapter 2, the Leninist character of the KMT meant that such high connections did not necessarily[47] translate into increased influence – although a greater understanding of party preferences and opportunities would inevitably have followed.

Thirdly and perhaps most importantly, the finance technocrats' declared reasons for limiting forex policy change really only made sense to the KMT faithful – even casual outside observers could see they were drastically over-determined. A typical rationalization included fear of mainland China; Yu occasionally argued that an open capital account would leave the RoC vulnerable to manipulation by the Chinese communists.[48] While there may have been some basic truth to this view, it assumes that capital controls were effective and that regulatory restrictions were synonymous with economic security. The reality was, however, that Taiwan's forex controls existed alongside a large illegal outflow of funds,[49] and that the established forex regime actually *increased* the mainland Chinese economic threat by (potentially) rendering all

[45] Yu had been the Chiang household's personal financial advisor since the 1930s, and was one of the few people that managed to cultivate a close relationship with both Chiang Kai-shek and his son CCK. Yu's first real taste of Ching-kuo's patronage, however, came in 1973 when he was appointed convener of a high-level advisory group – the 'five man finance and economics small group' or *wuren caijing xiaozu* – which stood above all other policy committees and reported directly to the new Premier. Thomas B. Gold, *State and Society in the Taiwan Miracle* (Armonk: M.E. Sharpe, 1986), p. 92.

[46] Yu-kou Zhou, *Li Deng-hui de Yiqian Tian: 1988-92* [A Thousand Days of Lee Teng-hui: 1988-92] (Taipei: Maitian Chuban, 1993), p. 99.

[47] I say 'not necessarily' here as under the right circumstances (i.e. the opening of a window of opportunity) high connections did most certainly make for increased influence on policy outcomes. The point is that influence was temporally as much as structurally specific.

[48] And on at least one occasion in the late 1990s, argued that a decrease in the security threat around 1987 was linked to the passage of foreign exchange reform. See: Wang, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [Finance Master: Yu Kuo-hwa's Life and Travels], fn. 26, p. 385. This claim, like the broader proposition that Taiwan's security situation prohibited forex opening, needs to be taken with a large grain of salt. Yu's pronouncements at the time leave little doubt that, as far as he was concerned, there was no change in the security relationship with mainland China over the course of his Premiership. See: Xue, *Bianju Zhong de Yuejin: Yu Guo-hua de Zhengyuan Wunian* [In the Midst of Critical Change: The Five Year Cabinet of Yu Kuo-hwa], fn. 41, p. 91-96 & 243-259; and *China News* (9 May 1988) [personal interview with Yu Kuo-hwa], p. 12. In this latter article, Yu stated categorically: 'I must first point out, up to present, there has been no change in the attitude of the government of the RoC toward the Chinese Communist regime.... Their basic formula is to "appeal to emotions and entice with profit" in hopes of changing people's impressions of the Chinese Communist regime and increasing Taiwan's dependence on the mainland, then to use Taiwan's residents to influence the government's policies. However, in actual practice, the Chinese Communists back up all their actions, both the indirect strategy of isolation and the direct one of enticement, with a hidden iron fist. *This threat has never diminished, and will not diminish in the future.*' Emphasis added.

[49] According to one estimate, illegal capital exports were in the order of US$3 billion per year by 1985. See: *Far Eastern Economic Review* (3 October 1985), p. 67.

RoC assets held abroad sovereign property.[50] Yu's team knew of these practical shortcomings, and yet publicly chose to ignore them. This was more the stuff of political apology than a defensible statement of policy principle.

3. The KMT policy windows for foreign exchange reform, early and late 1986

And so, convinced that the KMT would never countenance extensive foreign exchange liberalization, the pragmatic technocrats of the Yu Faction concealed their private assessment of the established exchange system, and feebly made the case for going slow on forex policy change. In so doing, the group had the pleasure of bearing the full burden of criticism forwarded by reform advocates. For the better part of a decade prior to 1987, a loose alliance of journalists, foreign bankers and economists targeted Yu and other 'protectionist policymakers'[51] as the chief obstacle on the road to forex reform. Little did this coalition realize, however, just how politically entrenched the old forex system actually was. Policy insiders like Yu, Chien and Chang, however, were keenly aware that forex liberalization would never be an option unless it could impress the KMT as a sound strategy (1) to secure socio-political support for the party, and (2) to buttress the party's cautious finance goals. Up to the end of 1985, the successful fulfillment of both criteria seemed too much to hope for.

As 1986 unfolded, however, both of these windows of opportunity opened, and opened far more rapidly and in-concert than anyone could have imagined. The first of the chances for change came in the early months of 1986, when the rising NT dollar began to put pressure on Taiwan's legion of small to medium sized enterprises (SMEs – *zhongxiao qiye*).[52] This was at

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[50] This latter point requires some elaboration. Following the RoC's string of diplomatic setbacks during the 1970s, the monetary authorities in Taiwan became extremely concerned about the status of RoC financial institutions abroad. It was feared that because these institutions were state-owned enterprises, their assets might be unilaterally claimed as sovereign property by Peking. As a consequence the government moved to distance itself from these institutions via privatization and a 'buyback' of instruments held overseas. While these issues were being discussed, it became apparent that *all* capital exports from the RoC potentially faced the same kind of threat from mainland China. Under the old system of forex controls, RoC citizens could only purchase overseas assets with the permission of the Central Bank of China; foreign exchange could only be held and traded by government authorities and after acquiring foreign currency from the Central Bank, citizens were effectively operating as government agents. This meant that in principle if not in practice, RoC capital held abroad was sovereign property and might be reclaimed as such by the Peking government. All things being equal, this was a more real economic threat than the 'manipulation' so often cited as a reason for retaining forex controls. Various interviews in Taipei, 1996 & 1999. For an introduction to the issues involved in this policy debate, see: R.B. Greenburgh, 'Sovereign Debt and the Republic of China' in *Chinese Yearbook of International Law and Affairs* Vol. 6 (1986-87); and Wang, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [Finance Master: Yu Kuo-hwa's Life and Travels], fn. 26, p. 325-328.

[51] A term used with considerable disdain in S.C. Tsiang, Wen-lang Chen and Alvin Hsieh, 'Progress in Trade Liberalization, Taiwan, Republic of China' in *Economic Review* [a bi-monthly journal published by the International Commercial Bank of China] No. 230 (March-April 1986), p. 5-6.

[52] The definition of a small to medium sized enterprise is not consistent across nations, and even within Taiwan there are multiple classifications based on industry sector. See: *Zhongxiao Qiye Rending Biaojun* [Criteria for Identification of Medium and Small Enterprises] (Taipei: Industrial Development and Investment Center, Ministry of Economic Affairs, 1995). More often than not, however, the 'rule of thumb' definition used by the World Bank, Asian Development Bank and other international agencies is also adhered to in Taiwan. This definition stipulates that a firm may be regarded as an SME simply if it

first a major socio-political problem for the ruling party, but was soon reduced to a policy question when forex reform was proposed as an adjustment palliative. The backdrop to this episode can be traced to the early 1960s when the KMT regime first launched Taiwan along the path of export oriented industrialization (EOI). EOI was, at least initially, the KMT's response to a range of negative economic and political incentives that emerged in the 1950s: the failure of the old import industrialization strategy to deliver sustainable growth, rampant rent seeking around the established arrangements for trade and foreign exchange, pressure from the US for Taiwan to decrease its dependence on American aid, and the increasing realization that the ruling party's goal of 'retaking the mainland' (*fangong dalu*) would never be achieved.[53] Once launched, however, EOI proved even more successful than the ruling party could ever have hoped. Not only did it facilitate a massive improvement in Taiwan's economic performance (performance statistics included in chapter 3, section three), it also contributed to a style of development that the KMT regime could happily live with. As noted earlier in the thesis, the

TABLE 4.2 Number of SMEs and proportion of total firms, select years

1961		1971		1981		1989	
178,916	99.6%	274,362	98.3%	508,784	99.1%	778,042	97.4

Source: *Zhonghua Minguo Taiwan Diqu Zhongxiao Qiye Tongji* [Small and Medium Enterprise Statistics, Taiwan Area, RoC] (Taipei: Medium and Small Business Administration, Ministry of Economic Affairs, various issues).

ruling party was not a natural friend of business interests on Taiwan, and the larger the business interests, the more unfriendly the relationship. The entrenchment of EOI in the 1960s and its maturation through the 1970s and 1980s occurred in tandem with a vast expansion in the number of SMEs on the island (from 178,916 in 1961 to 778,042 in 1989; see Table 4.2). These enterprises concentrated their production on the North American and European markets, and soundly dominated national exports (the proportion of RoC exports attributable to SMEs averaged around 62% for the 1980s; see comparative figures in Table 4.3). With the passage of time, a symbiotic relationship grew up between the SMEs and the ruling party. The SMEs were indebted to the KMT government for upstream supplies, a suppressed exchange rate, help with market entry and, more generally, the opportunity to do business and prosper; and the KMT came to depend upon the SMEs as a key group in its 'distributional coalition'[54] of party supporters.

has 100 employees or less. In the discussion that follows, we will use this basic definition unless otherwise noted.

[53] See esp.: Stephan Haggard and Chien-kuo Pang, 'The Transition to Export-Led Growth in Taiwan' in Joel D. Aberbach, David Dollar and Kenneth L. Sokoloff (eds.), *The Role of the State in Taiwan's Development* (Armonk: M.E. Sharpe, 1994), p. 69-83.

TABLE 4.3 Ratio of SME exports to total exports of Taiwan, Japan and South Korea, 1980-87

Period	RoC	Korea	Japan
1980	66.7%	15.4%	N/A
1981	74.8%	14.5%	N/A
1982	75.9%	14.1%	22.1%
1983	73.3%	14.5%	20.0%
1984	71.8%	13.5%	25.4%
1985	70.0%	13.3%	27.8%
1986	66.4%	12.7%	35.2%
1987	62.5%	12.6%	37.7%

Source: Pang-tien Liu, Ying-che Sun and Pei-hsuan Chou, *The Development of Small and Medium-Sized Enterprises in the Republic of China, Volume 5* [final part of a five volume series edited by the Chung-hua Institute of Economic Research] (Taipei: Ministry of Economic Affairs, 1995), p. 65.

It is worthwhile briefly considering the character and demographics of the KMT's army of petite capitalists. Writing in the mid to late 1980s, Western scholars such as Susan Greenhalgh and Gordon Redding described the typical small to medium sized enterprise in Taiwan as: an owner-operator firm with weak horizontal and vertical links, ethnically Taiwanese, based on a simple family organizational structure with fused management and proprietorship, and extremely price sensitive. Usually Taiwan's SMEs concentrated their production on labor intensive goods like toys, footwear, clothing, textiles, sporting goods, household appliances and so on. Firms with the above characteristics constituted around 98% of all enterprises in the RoC. While some SMEs managed to pass the test of time, most were disbanded within a generation; bankruptcies were common. As a group, they were utterly dependent on upstream producers for basic inputs like petrochemicals, steel, electricity, telecommunications, cement and, of course, finance – concerns which were almost invariably government-owned and operated.[55] More recent studies of Taiwan's leading export industries published in Chinese (including textiles, machine tools and consumer electronics) generally confirm the image of the island's SMEs forwarded by Greenhalgh and others. Nonetheless, these works point to a number of caveats. They emphasize two things which qualify any presumption of acute market weakness among the SMEs: the importance of intra-industry networks between Taiwan's small enterprises as a possible substitute for firm size and organizational capacity, and the key role

[54] The term first coined by TJ Cheng in: Tun-jen Cheng, 'Political Regimes and Development Strategies: South Korea and Taiwan' in Gary Gereffi and Donald L. Wyman (eds.), *Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia* (Princeton: Princeton University Press, 1990).

[55] See esp.: Susan Greenhalgh, 'Families and Networks in Taiwan's Economic Development' in Edwin A. Winckler and Susan Greenhalgh (eds.), *Contending Approaches to the Political Economy of Taiwan* (Armonk: East Gate, 1988); Susan Greenhaugh, 'Networks and Their Nodes: Urban Society on Taiwan' in *China Quarterly* No. 99 (September 1984); and S. Gordon Redding, *The Spirit of Chinese Capitalism* (Berlin: Walter de Gruyter, 1990).

played by geographical location in Taiwan as a determinant of enterprise bargaining power vis-à-vis suppliers and distributors.[56]

TABLE 4.4 NT dollar/US dollar exchange rate, select years 1960-90

Period	Exchange Rate	Period	Exchange Rate
1960	36.23	1978	36.00
1965	40.05	1979	36.03
1966	40.05	1980	36.01
1968	40.05	1981	37.84
1969	40.05	1982	39.91
1970	40.05	1983	40.27
1971	40.05	1984	39.47
1972	40.05	1985	39.85
1973	38.00	1986	35.50
1974	38.00	1987	28.55
1975	38.00	1988	28.17
1976	38.00	1989	26.16
1977	38.00	1990	27.11

Sources: Yu-jen Chou, 'US-Taiwan Trade Conflicts (1984-1989): The Political Economy of Accelerated Trade Liberalization in Taiwan' unpublished Ph.D. manuscript, Ohio State University (1990), p. 205-206; and *Taiwan Statistical Data Book, 1996* (Taipei: Council for Economic Planning and Development, 1996).

For a quarter of a century after 1960, Taiwan's small to medium-sized enterprises received a helping hand in international export markets via a stable and undervalued exchange rate (see Table 4.4 for exchange rate data). The New Taiwan dollar was pegged to the greenback at NT$40:US$1 in the early years of EOI, and only underwent two episodes of appreciation in 1973 and 1976 (leaving the rate at around NT$36:US$1 by the end of the 1970s). These upward revaluations were later undone, and by 1982 the exchange rate had returned to its earlier level. Thereafter, the rate remained largely unchanged until late 1985 when, in tandem with the Plaza-Louvre revaluation of the US dollar, the RoC was forced to strengthen its currency.[57] Under the Plaza-Louvre agreements (covering the period between late 1985 and late 1987), the US compelled its major trading partners to devalue the greenback by more than 35% in international

[56] See for example: Chih-ming Ka, *Taiwan Dushi Xiaoxing Zhizaoye de Chuangye, Jingying yu Shengchan Zuzhi* [Market, Social Networks and the Production Organization of Small-scale Industry in Taiwan] (Taipei: Academia Sinica, 1993); and Jie-xuan Chen, *Xieli Wanglu yu Shenghuo Jiegou: Taiwan Zhongxiao Qiye de Shehui Jingji Fenxi* [Cooperative Networks and the Structure of Livelihood: A Socio-economic Study of Taiwan's Small to Medium Sized Enterprises] (Taipei: Lianjing Publishers, 1994). These works raise the prospect of seeing business entities on Taiwan as something more than detached and distinct corporations. In the chapter 5 we turn to the issue of Taiwan's *guanxi qiye* or related enterprises.

currency markets.[58] During this period, Taiwan's volumous trade surplus with the US made it an easy target for American pressure on the exchange-rate issue – indeed, quite out of keeping with the RoC's comparative economic size. In the three years to 1987, the bilateral trade imbalance came in at a colossal US$10 billion, US$13.5 billion and US$16 billion respectively – the culmination of nearly two decades of ever-increasing surpluses. The image of Taiwan as an 'unfair trader' which these figures elicited in Washington was compounded by a high concentration of Taiwan exports in American markets: Taiwan's export dependency attained its peak in 1984-85, when just less than 50% of total RoC exports went to the US.[59]

The course and character of NT dollar appreciation after 1986 was a function of US threats and lobbying on the one hand, and stalling by the KMT regime to shield Taiwan's SMEs on the other. From a baseline of approximately NT$40/US$1 (following figures from Table 4.4), appreciation occurred in three main 'surges' over the ensuing three to four years.[60] These periods of intense appreciation roughly covered early to mid 1986, mid to late 1987, and early to mid 1989 – the second surge being the largest. Over all, the local currency appreciated some 40% against the greenback, leaving an average exchange rate of around NT$26/US$1 in the last year of the decade. Apart from the implied pressure for NT dollar appreciation engendered by the plunge in the greenback on international markets, US demands for currency realignment were typically conveyed to the RoC government within the context of the Sino-American Exchange Talks (*Zhong-Mei Huilu Tanpan*) – a feature of US-RoC economic relations that commenced in early 1986 and dovetailed with ongoing bilateral trade negotiations.[61] These talks were backed up with the threat of retaliatory action in the event of non-compliance, and on at least two occasions (mid 1986 and early 1987) elicited the direct intervention of President Reagan.[62] Despite the intensity of US pressure, the KMT regime firmly resisted calls for a one-off increase in the NT$/US$ exchange rate. In an effort to absorb the worst effects of the currency realignment on Taiwan's SMEs, the Central Bank of China publicly committed itself

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[57] This brief history of NT dollar exchange rate movements is taken from: Bela Balassa and John Williamson, *Adjusting to Success: Balance of Payments Policy in the East Asian NICs* (Washington: Institute for International Economics, 1987), p. 60.

[58] And of course the classic here is: Yoichi Funabashi, *Managing the Dollar: From the Plaza to the Louvre* (Washington: Institute for International Economics, 1988). For a broader view of America's 'aggressive unilateralism' of this period, see: Jagdish Bhagwati, 'Aggressive Unilateralism: An Overview' in Jagdish Bhagwati and Hugh T. Patrick (eds.), *Aggressive Unilateralism: America's 301 Trade Policy and the World Trading System* (Ann Arbor: University of Michigan, 1990).

[59] Figures and comments from: Yu-jen Chou, 'US-Taiwan Trade Conflicts (1984-1989): The Political Economy of Accelerated Trade Liberalization in Taiwan' unpublished Ph.D. manuscript, Ohio State University (1990), p. 205-206 & 222-264.

[60] Following points and observations garnered from: *Tianxia Zazhi* [Commonwealth Magazine] (various issues, 1986-89).

[61] For more on the trade negotiations, see esp.: Chou, 'US-Taiwan Trade Conflicts (1984-1989),' fn. 59; Chung-li Wu, 'Some Measures to Promote a More Balanced Bilateral Trade Relationship Between the RoC and the USA: Economic and Political Implications' in *Industry of Free China* Vol. 67, No. 3 (September 1987); and Vincent C. Siew, 'Toward Liberalizing Trade and Improving Market Access' in *Economic Review* [a bi-monthly journal published by the International Commercial Bank of China] No. 239 (September-October 1987).

[62] *Lianhe Bao* [United Daily News] (11 September 1987), p. 1-3.

to a measured increase in the rate (throughout most of 1986, a daily rise of NT$0.01) and conducted offsetting purchases of foreign exchange for the entire period of revaluation. This was an expensive tactic: at the end of 1987, the government revealed the Central Bank had already made a paper loss on its mounting pile of forex to the tune of US$12.2 billion.[63]

The forced increase in the NT$ exchange rate set the stage for the first policy window for securities reform. Despite the KMT regime's best efforts to postpone the inevitable, SME representatives and their friends complained bitterly about the rising NT dollar. They channeled their anger through the media, legislators, industry associations and various government agencies, in particular the Medium and Small Business Administration of the Ministry of Economic Affairs (*Jingjibu Zhongxiao Qiye Ju*).[64] And not without some justification: the economic impact of the appreciation of the NT dollar was decidedly painful for many of Taiwan's SMEs. As overseas orders for Taiwan's low value-added products began to decrease, a pattern of disinvestment or 'hollowing out' gathered pace with negative implications for the island's small firms. Although this process was masked by continuing strong demand in the US and strong overall economic performance at home, traditional SME industries gradually lost ground to a range of capital-intensive industries with large economies of scale. As of May 1987, for example, value-added electronics and machinery grew by 32% and 24% respectively on the same period for 1986. For garments and textiles, however, it was another story entirely: these sectors increased by a modest 4.9% and 6.2% respectively over the same time frame. These were poor results indeed in an economy that expanded by greater than 11% in 1986 and more than 12% in 1987. Behind these figures, SME industry representatives reported that their already slim profit margins (e.g. for most shoe manufacturers, typically around 2-3%) had disappeared entirely. They maintained that any output or export growth recorded in the short to medium term was attributable to firms dumping their product at below cost – a last-ditch effort aimed at preserving market share abroad. Attempts to diversify export markets were slow and had met with limited success. While Europe and Japan were now more attractive destinations for RoC products due to the US dollar exchange rate realignment (which left the Yen and Deutsch-mark stronger against the NT dollar), these markets were not as well understood by Taiwan's small-scale entrepreneurs, and were more protectionist than the US. Market diversification, much less product diversification, was simply too expensive for many family firms. For a significant number, cutting back production was a natural first choice, and after that, industry exit.[65]

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[63] *Taiwan Country Report, No. 1, 1988* (London: Economist Intelligence Unit, 1988), p. 15.

[64] Various interviews in Taipei and Taichung with small business proprietors. For information on the sensitivity and response of SMEs to exchange rate movements, I am especially indebted to interviews in Taichung County with Mr Tong Su, Export Vice Manager, and Yen-ping Huang, General Manager, Chen Ho Iron Works, 13 April 1996.

[65] We will never know just how much Taiwan's SMEs were burned by the NT$ appreciation of the late 1980s, as statistics on individual SME performance in Taiwan were and remain notoriously unreliable. Some economists at the time suggested in fact that the rate rise merely 'trimmed the fat' of these firms leading to widespread cost cutting rather than production cutbacks or industry exit. See for example

Through early 1986, as Taiwan's small to medium sized enterprises cried foul, foreign exchange reform rapidly took on the form of a convenient policy placebo for the KMT – a palliative with the potential to reaffirm the social contract between the ruling party and the SMEs. There were at least two sides to this emergent incentive for reform. Firstly, *real* forex reform (as opposed to the tinkering which had characterized 'liberalization' initiatives in the past) held the potential to reward SMEs with a foreign currency side payment of no direct fiscal cost to the government.[66] Under the pre-1987 foreign exchange regime, the great bulk of foreign currency earned abroad had to be traded at the border for NT dollars. Ultimately, the official custodian of all foreign funds in Taiwan was the Central Bank of China; foreign currency could not be held or traded by anyone on the island apart from the Central Bank or its agents. Naturally, this scheme severely restricted the financing and expenditure options of Taiwan's SME exporters. Usually too small to contemplate playing money games offshore (in avenues such as the Euro money market, the preferred choice of Japan's large trading companies by this time),[67] Taiwan's SMEs were not only deprived of basic freedoms regarding income disposal, they also paid a heavy premium in forex transaction costs.[68] Permitting SMEs to retain their foreign earnings would be a huge bonus for these firms. It would allow them to trade, invest or just squander their money abroad – and make the KMT regime look like a generous benefactor in the process.

Secondly, forex reform allowed the ruling party to make a political virtue out of the industrial hollowing-out threatening Taiwan's SMEs, and the increasing illegal investment abroad associated with it. As the traditional SME industries endured an upward trend of disinvestment, small-scale entrepreneurs faced strong incentives to relocate their labor intensive businesses in low cost economies. South East Asia and mainland China were the natural recipients of such capital exports, although established foreign exchange regulations in Taiwan made the process of relocation extremely difficult – extremely difficult, but *not* impossible for SMEs adept at operating in gray and black markets. A substantial illicit flow of funds was making its way out of Taiwan regardless of government restrictions. For example, RoC data indicate that as of mid 1987, episodes of officially permitted investment by Taiwan companies in Thailand and Malaysia totaled just 29 cases (US$15 million) and 19 cases (US$7.2 million) respectively. Statistics from the target countries, however, indicate that there were 138 cases of Taiwan investment in Thailand (US$36 million), and 332 cases in Malaysia (US$25 million).[69] While there are no statistics on Taiwan investment in mainland China before forex reform in 1987, anecdotal reports suggest that by 1985 it was well underway and probably served as an

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comments by Dr Wu Chung-li from Academia Sinica in *China News* (22 June 1987), p. 8. Correlating and anecdotal evidence of the kind included herein, however, suggest that they were under extreme strain through 1986, 1987 and beyond. Comments and data from: *Far Eastern Economic Review* (16 July 1987), p. 72-73; and *Tianxia Zazhi* [Commonwealth Magazine] (1 October 1986), p. 130-135.

[66] Following points from interviews with various economists in Taipei, 1996.

[67] Rosenbluth, *Financial Politics in Contemporary Japan*, fn. 21, chp. 5.

[68] Various interviews in Taipei and Taichung with small business proprietors, 1996 and 1999.

adjunct to the flourishing indirect trade across the Taiwan Strait (usually routed via Hong Kong).[70] With forex reform, the government could rapidly turn these illegal flows into legitimate investment abroad, and thereby give its blessing to the hitherto criminal activities of a large number of Taiwan's SMEs. Again, with a relatively straightforward policy shift, the KMT regime could reinvent itself as a benefactor of the island's small business community.

Genuine forex reform became a possibility in early 1986 as the ruling party sought ways and means to compensate Taiwan's SMEs for the effect of the rising NT dollar; a socio-political window of opportunity had opened within the ruling party. The political problem of SME adjustment was reduced to a policy question when forex reform was proposed as an adjustment placebo. We will examine in the following section of this chapter just how the finance technocrats turned this chance for change into a concrete program of forex opening, but for now we are left with a quandary. We know from section one of this chapter that forex reform was in fact an expeditious process, particularly when measured against the case of securities liberalization. Reform started in early to mid 1986, peaked in mid 1987, and concluded just two years later; by contrast, securities liberalization seemed to drag on forever. Was this hurried process of change entirely attributable to the KMT's political calculations regarding local SMEs? Although SME suffering may have been sufficient to kick-start forex reform in early 1986, our theory of technocratic leadership suggests that it would have been insufficient to see the task completed. The speedy pattern of forex reform would suggest that the socio-political window of opportunity considered above *only just preceded* the opening of the KMT's 'sectoral-strategy window.' That is to say, some time between early 1986 and the middle of 1987, the KMT regime must have had cause to believe that the established forex system was not living up to the regime's policy expectations – i.e. it was not supporting the ruling party's finance goals of stability and control. Do we have evidence of this second aperture appearing within the ruling party in such quick succession?

Before moving on to the task of answering this question, it is first necessary to consider some technical issues surrounding the administration of foreign exchange. On both a theoretical and practical level, the operation of foreign exchange regimes present governments with an awkward dilemma, or rather 'trilemma.' The key issue at stake, first analyzed in detail by the Canadian economist Robert Mundell in the late 1960s, is that foreign exchange regimes will *never* deliver all the policy outcomes demanded of them. Often called the problem of the 'unholy trinity,'[71] it is thought impossible to construct a foreign exchange system that

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[69] *China News* (15 June 1987), p. 8.

[70] Ricky Tung, 'Mainland China in Taiwan's Economic Future' in *Issues and Studies* Vol. 26, No. 5 (May 1990), p. 40. See also: Tzung-ta Yen, 'Taiwan Investment in Mainland China' in *Issues and Studies* Vol. 27, No. 5 (May 1991); and Ai Wei, 'The Development and Limitations of Taiwan-Mainland Economic and Trade Relations' in *Issues and Studies* Vol. 27, No. 5 (May 1991).

[71] This term was first coined by B.J. Cohen in Benjamin J. Cohen, *Organizing the World's Money: The Political Economy of International Monetary Relations* (New York: Basic Books, 1977). Cohen has since applied and extended the concept with interesting results. See, for example: Benjamin J. Cohen, 'The Triad and the Unholy Trinity: Lessons for the Pacific Region' in Richard Higgot, Richard Leaver

simultaneously permits: (1) an independent monetary policy so that governments can engage in counter-cyclical interest rate changes; (2) a stable exchange rate to avoid uncertainty for business and disruptions to the domestic financial system; and (3) full currency convertibility, ideally to ensure an optimum flow of capital and technology in and out of the country, but short of this, to avoid the red tape and rent seeking usually associated with capital controls.[72] Foreign exchange regimes can support any *two* of these policy properties, but not all *three* at once.

Paul Krugman demonstrates the trilemma with reference to a hypothetical country that attempts to include all three characteristics into its forex system. He postulates an example with free capital mobility and a fixed exchange rate (which we'll call the nation of 'XO' in deference to the popularity of fortified spirits in Taiwan). What would happen to XO if it sought to unilaterally cut interest rates to fight a recession? Domestic investors would see a profit opportunity in the disparity between domestic interest rates and comparatively higher rates in other countries. They would sell-up their XO assets (or borrow in XO dollars), exchange the proceeds for foreign currency and invest abroad. To prevent the increased supply of XO dollars from driving down the value of the XO dollar exchange rate, the Central Bank of XO would have to buy-up any excess local currency with its reserves. At some point with reserves depleted, the monetary authorities of XO would either have to increase interest rates (i.e. abandon independent monetary policy), let the XO dollar depreciate (i.e. give up the goal of exchange rate stability), or impose capital controls (i.e. give-up convertibility). The bottom-line is '...any exchange rate system involves sacrificing some important objectives to achieve others.'[73]

The problem of the unholy trinity forces countries to choose among three basic forex systems: (1) a floating rate system, which permits freedom of international transactions and independent monetary policy, but at the expense of an unpredictable exchange rate; (2) a fixed rate system, which permits exchange rate predictability, but without an independent money supply; and (3) capital controls, which can marry some level of monetary independence with a relatively stable exchange rate, but only insofar as capital controls actually function as intended and domestic economic aggregates (savings, investment, consumption) are kept more or less in balance through demand management.[74] For the KMT regime, with its attachment to stability *and* managerial prerogative, the natural choice among these three alternatives was capital controls.[75] On the one hand, capital controls purchased crucial insurance against the ruling

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and John Ravenhill (eds.), *Pacific Economic Relations in the 1990s: Cooperation or Conflict?* (St. Leonards, NSW: Allen & Unwin, 1993), chp. 7.

[72] Robert A. Mundell, *International Economics* (New York: Macmillan, 1968), esp. chp. 16-18.

[73] Paul D. Krugman, 'The Return of Depression Economics' in *Foreign Affairs* Vol. 78, No. 1 (January-February 1999), p. 60-61. See also: http://web.mit.edu/krugman/OldFiles/www/ [the official home page of Paul Krugman].

[74] Krugman, 'The Return of Depression Economics,' fn. 73, p. 61.

[75] For the sake of positioning the Taiwan case neatly against Krugman's three alternatives, we include within the term 'capital controls' the broad system of forex restrictions encompassed by the SAFE. In reality, the SAFE was considerably more complex than a straightforward system of capital controls – e.g.

party's long-standing fear of capital flight and chronic trade deficits (as mentioned in chapter 2, section two). These traditional fears dovetailed well with the KMT's later conversion to export oriented industrialization and the need to provide local SMEs with a stable platform for international trade (as mentioned above). On the other hand, and of equal importance, capital controls allowed the KMT government to keep a tight check on domestic inflation. As outlined earlier in the thesis, the Nationalists were convinced that their complicity in the mainland hyperinflation of the 1940s had been crucial in deciding the outcome of the Chinese Civil War. Once ensconced on Taiwan, they were determined not to repeat the mistakes of the past – and this meant high interest rates, balanced fiscal budgets and a cold printing press.

And for a time, the chosen forex system delivered acceptable results for the ruling party. Over the period spanning the 1950s to the early 1980s, capital exports were reduced to a trickle (in 1981, for example, officially approved outward direct investment by RoC citizens was all of US$60 million), and the traditional propensity to import more than export was finally wedged into a corner (Taiwan recorded the first of a string of trade surpluses in 1969). Further, with only one or two exceptions, inflation was also kept at bay. Excellent results were recorded over the 1960s (the CPI typically hovered between 3-4%), and above international average results recorded for the 1970s (with the exception of the price leap of 1974, the RoC averaged 5.9% CPI inflation for the decade).[76] But just as the KMT regime was starting to congratulate itself on the creation of an 'economic miracle'*(jingji qiji)*, the established forex policy mix began to come under stress. A sectoral-strategy window of opportunity for forex reform was slowly taking shape – a nascent aperture that would ultimately and dramatically fly open in late 1986. By the early to mid 1980s there were growing signs that Taiwan's macroeconomic fundamentals were becoming progressively unbalanced. From this time on, it was readily apparent that national savings in Taiwan were up, private investment was slowing down, and external (i.e. US) demand for RoC goods and services was strengthening. Decade on decade from the 1950s to the 1980s, savings rates in the RoC saw an upward trend. Starting-out from a healthy 14.9% of GNP in the 1950s, this savings ratio increased to 21.0% in 1961-70, 31.9% in 1971-80, and finally 33.6% in 1981-88. Juxtaposed against this escalating savings record, the pattern of gross domestic investment traces a bell-shaped curve over the same time frame. Commencing at 16.1% of GNP for 1951-60, investment climbed to 21.9% in 1961-70 and then 30.5% in 1971-80, before dipping to 21.8% for the 1980s.[77] And just as the Taiwan economy was developing all the signs of structural recession, the external sector received a boost from policy settings in the US. Tight money and increased defense expenditure in the early Reagan

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the web of limitations on the flow of trade-related funds. Of Krugman's three models, however, capital controls is certainly the closest approximation to Taiwan's old forex system.

[76] All preceding statistics from *Taiwan Statistical Data Book, 1996* (Taipei: Council for Economic Planning and Development, 1996); or Tables 4.5 & 4.7.

[77] Data and comments from: Jia-dong Shea and Ya-hwei Yang, 'Taiwan's Financial System and the Allocation of Investment Funds' in Joel D. Aberbach, David Dollar and Kenneth L. Sokoloff (eds.), *The*

years saw a dramatic rise in US consumption, the appreciation of the US dollar and (consequently) rising imports.[78] Given Taiwan's strong dependence on the US for export markets, Reaganomics soon found its way to the shores of Taiwan in the form of increased US demand for RoC products.

TABLE 4.5 RoC trade balance and balance as % of GNP, 1969-90 (US$1,000s)

Period	Balance	% of GNP	Period	Balance	% of GNP
1969	-12,000	-0.2%	1980	3,343,000	8.0%
1970	106,000	1.9%	1981	1,937,000	4.0%
1971	291,000	4.4%	1982	3,746,000	7.7%
1972	648,000	8.2%	1983	6,329,000	12.0%
1973	734,000	6.8%	1984	9,262,000	15.5%
1974	-830,000	-5.7%	1985	11,151,000	17.6%
1975	-255,000	-1.7%	1986	16,910,000	21.8%
1976	685,000	3.7%	1987	20,160,000	19.5%
1977	1,166,000	5.4%	1988	13,690,000	10.8%
1978	2,189,000	8.2%	1989	16,115,000	10.6%
1979	1,304,000	3.9%	1990	14,807,000	9.0%

Notes: We include here the 'free on board' (fob) figures for merchandise trade rather than the 'cost, insurance and freight' (cif) prices. With trade invoicing, over-insuring and bogus freight charges used as important tools of exchange control avoidance in Taiwan during the late 1980s, we can assume that the cif price dampens the BoT trend well beyond that which can be explained simply in terms of trade-linked invisibles.
Sources: *Taiwan Statistical Data Book* (Council for Economic Planning and Development, Republic of China, 1985 and 1999 issues); and *Balance of Payments Quarterly, Taiwan District RoC* (Central Bank of China, Republic of China, various issues).

In a manner not dissimilar to Japan during the same period,[79] the coincidence of these three factors occasioned the development of an increasingly large and persistent trade surplus for the RoC over the 1980s. The figures for pure merchandise trade best demonstrate the fundamental trends, and are certainly the most spectacular statistics (see Table 4.5). Throughout the decade, Taiwan recorded some of the largest trade surpluses ever experienced by a non-oil producing country. Between 1980 and 1990, the surplus maintained an average of around 12.4% of GNP per year. For seven of those years – 1983 to 1989 – the surplus was greater than 10% of GNP ever year. In 1986, the surplus hit an all-time high as a percentage of national income at 22% of GNP (just under US$17 billion), and a year later an all-time high nominal figure of US$20 billion (or 19.5% of GNP). Only a small number of OPEC countries have experienced such

Role of the State in Taiwan's Development (Armonk: M.E. Sharpe, 1994), chp. 8. Statistics rounded to the nearest 0.1%

[78] From: Gerald Epstein, 'The Triple Debt Crisis' in *World Policy Journal* Vol. 2, No. 4 (1985).

[79] See for example: Peter Drysdale, *Japan as a Pacific and World Economic Power, Pacific Economic Papers No. 166* (Canberra: Australia-Japan Research Centre 1988).

large surpluses as a percentage of national product over such a long time. Among economies with a manufacturing base, Taiwan's trade profile in the 1980s was quite unique.[80]

TABLE 4.6 RoC national reserves (in US$1,000,000s), select years 1960-1991

Period	Reserves	Period	Reserves
1960-'78	1,406	1985	22,556
1979	1,467	1986	46,310
1980	2,205	1987	76,748
1981	7,235	1988	73,897
1982	8,532	1989	73,224
1983	11,859	1990	72,441
1984	15,664	1991	82,405

Sources: *Taiwan Statistical Data Book* (Council for Economic Planning and Development, Republic of China, 1985 and 1999 issues); and *Balance of Payments Quarterly, Taiwan District RoC* (Central Bank of China, Republic of China, various issues).

But why did the trade surplus imply problems for the KMT regime's preferred forex system? As noted above, a successful foreign exchange mechanism based on capital controls requires that the restrictions placed on inward and outward remittances actually work, and that any domestic economic imbalance is rectified with demand management. Aside from increasing evidence that evasion of Taiwan's capital controls was a growth industry (see comments above, and note related points on 'hot money' below), the KMT regime's options with fiscal policy remained limited over the period in question. As noted in chapter 3, a major fiscal stimulus to reduce national savings had been precluded at the start of the decade.[81] This policy stance was more or less locked in when Chiang Ching-kuo became President in 1978, and was set in stone with the economic plans of the early 1980s. While officially the so-called 14 Major Projects (*Shisixiang Jianshe*) had been included in budget projections since mid 1985,[82] this policy plan was extremely slow to get off the ground and by and large was a case of too little, too late. The reluctance to resort to a major fiscal stimulus left the government with an increasing problem of monetary control. The established forex system obliged the Central

[80] Comments from: Shiu-Tung Wang, 'Taiwan's Persistent Trade Surpluses: The Policy Choices,' unpublished Ph.D. manuscript, University of California, Davis (1989), esp. chp. 1; Maxwell J. Fry, *Should Taiwan Reduce Its Current Account Surplus?* (Irvine: University of California, 1988); and Wing Thye Woo and Liang-Yn Liu, 'Taiwan's Persistent Trade Surpluses: The Role of Underdeveloped Financial Markets' in Joel Aberbach, David Dollar and Kenneth L. Sokoloff (eds.), *The Role of the State in Taiwan's Development* (Armonk: M.E. Sharpe, 1994).

[81] Various interviews with MoF and CBC officials in Taipei, 1996 and 1999. See also: CEPD, 'Macroeconomic Planning for Taiwan, Republic of China' in *Industry of Free China* Vol. 53, No. 6 (June 1980), esp. p. 18-19 & 24; CEPD, 'Prospects for Economic Development, Targets and Measures' [excerpts from the CEPD's Four-Year Development Plan, 1982-'85] in *Industry of Free China* Vol. 57, No. 3 (March 1982); and Cheng-chi Chang, 'RoC Fiscal Policy and Development Financing' in *Industry of Free China* Vol. 52, No. 6 (December 1979). For a critique of the government's fiscal conservatism at this time, see: Ching-huei Chang, 'Public Finance' in Gustav Ranis (ed.), *Taiwan: From Developing to Mature Economy* (Boulder: Westview Press, 1992).

Bank of China to absorb nearly all of the inward flow of foreign exchange created by the burgeoning trade surplus (reserve figures from Table 4.6). In the half decade to 1985, the Central Bank's already healthy stock of foreign reserves increased from around US$2.2 billion to US$22.5 billion. Thereafter, in 1986 the CBC's pool of foreign currency leaped to US$46 billion and then in 1987, an astounding US$76.7 billion. The issuance of domestic currency to purchase incoming foreign exchange resulted in a dramatic increase in the local money supply (see Table 4.7). In the period between 1981 and 1989 the average annual growth rate of M2 (currency in circulation plus bank deposits and quasi-money – a good indicator of longer-term monetary trends) averaged 22% per annum. In 1986 and 1987, M1B (currency in circulation plus most deposits – an important indicator of short-term monetary conditions) increased at the unprecedented rate of 51.4% and 37.8% respectively.

Confirming Mundell's dictum that foreign exchange systems *never* deliver all the policy outcomes demanded of them, the dramatic expansion of money naturally raised the specter of inflation.[83] The KMT regime saw its goals of stability and control potentially undermined by this, and from around mid to late 1986 the ruling party commenced a preemptive search for solutions. While a general increase in prices was in fact avoided (more on this below), by the end of 1986 the ruling party had reasonable cause to be concerned. It was increasingly apparent by this time that a large component of the trade surplus was not trade-related at all, but *hot money*. 'Hot money' (*riqian* or *youzi* in Chinese) is a colloquial term for speculative funds, and usually refers to those speculative investments conducted in the face of an exchange rate realignment.[84] Gathering pace around June-July 1986, the rise of the NT dollar attracted an increasingly large inflow of hot money by investors betting against the CBC's 'go slow' appreciation policy. Faced with strong expectations of NT dollar appreciation, these speculators were making a killing buying in and out of the local currency. For the most part, this illegal practice was conducted by legitimate RoC businesses engaged in foreign trade, typically utilizing techniques such as over and under invoicing, delayed contract fulfillment, and so on. In an ironic reversal of the ruling party's original fear of capital flight, estimates put the amount of money flowing into Taiwan at this time at around US$1 billion a month, much of it thought to be former flight capital parked in the US and Hong Kong.[85] Personnel from authorized foreign exchange banks described cases of blatant manipulation of the official forex transaction procedures; one bank officer described a case in which the actual price of a shipment of exports

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[82] *Taiwan Country Report, No. 1, 1988* (London: Economist Intelligence Unit, 1988), p. 11-12.
[83] For a particularly useful analysis of the emergence of this threat, see: *Tianxia Zazhi* [Commonwealth Magazine] (1 November 1986), p. 161-164.
[84] Graham Bannock, R.E. Baxter and Evan Davis, *The Penguin Dictionary of Economics*, 5th ed. (London: Penguin Books, 1992), p. 197.
[85] *Far Eastern Economic Review* (21 May 1987), p. 97.

and the associated application for foreign exchange presented at his bank *differed by more than a factor of 10.*[86]

TABLE 4.7 Annual growth of prices and money in Taiwan, 1979-90

	[	Prices	]	[	Money	]
Period	GDP Def.	WPI	CPI	M1A	M1B	M2
1979	11.5	13.8	9.7	11.1	7.7	9.6
1980	16.2	21.6	19.0	20.0	22.7	21.9
1981	12.1	7.6	16.3	9.0	13.8	18.9
1982	3.4	-0.2	3.0	5.9	14.6	24.3
1983	1.9	-1.2	1.4	14.7	18.4	26.4
1984	0.9	0.5	0.0	5.8	9.3	20.1
1985	0.6	-2.6	-0.2	7.9	12.2	23.4
1986	3.4	-3.3	1.2	46.1	51.4	25.3
1987	0.5	-3.3	0.5	32.3	37.8	26.6
1988	1.1	-1.6	1.3	23.4	24.4	17.9
1989	3.1	-0.4	4.4	17.9	6.1	15.3
1990	3.8	-0.61	4.1	-9.5	-6.6	9.9

Notes: As defined by the RoC monetary authorities M1A, is base money (i.e. money in circulation) plus demand deposits at banks, M1B is M1A plus most long-term deposits with banks, and M2 is M1B plus quasi-money (e.g. RoC treasury bills).
Sources: Ya-hwei Yang and Jia-dong Shea, 'Money and Prices in Taiwan in the 1980s' in Takatoshi Ito and Anne O. Krueger, *Financial Deregulation and Integration in East Asia* (Chicago: University of Chicago Press, 1996); *Taiwan Statistical Data Book, 1996* (Taipei: Council for Economic Planning and Development, 1996); and *Zhonghua Minguo Taiwan Diqu Jinrong Tongji Yuebao* [Financial Statistics Monthly, Taiwan District, RoC] (Taipei: Economic Research Department, Central Bank of China, 1996).

By late 1986, it was clear that the KMT regime had an inflationary threat on its hands considerably more complicated and intractable than anything it had confronted in the past. The challenge presented to the KMT's finance goals by the trade surplus buttressed the socio-political argument for forex reform. Thus, through late 1986, the second policy window opened – i.e. the sectoral-strategy window. In less than 12 months, forex reform had become an entirely judicious strategy for the ruling party. Hereafter, the potential for reform to complete a full cycle of adjustment was high indeed.

4. Guiding the great leap

In the discussion above we have seen how, in early and late 1986, foreign exchange reform rapidly emerged as a sensible political strategy for the KMT regime. There is a strong correlation between the ruling party's two policy windows and the process of forex reform:

[86] Estimates and comments from: *Tianxia Zazhi* [Commonwealth Magazine] (1 June 1986), p. 70; *Tianxia Zazhi* [Commonwealth Magazine] (1 January 1987), p. 159; *Far Eastern Economic Review* (18 June 1987), p. 58-59; and *Far Eastern Economic Review* (21 May 1987), p. 97.

foreign exchange liberalization starts in early 1986 as the socio-political window opens, and then culminates (and ultimately concludes) not long after with the emergence of the sectoral strategy window at the end of the year. The opening of the two KMT policy windows was a prerequisite for forex liberalization; however, reform did not take place spontaneously. Change was ultimately dependent on instrumental effort by interested policy elites. At this point in the narrative, we return to Yu Kuo-hwa's finance technocrats. I would argue that the finance technocrats seized upon the KMT policy windows to initiate their plans for forex reform. What evidence do we have to confirm this proposition?

As with the previous chapter, three items of evidence are significant. First, it is readily apparent that the emergence of the KMT policy windows in early and late 1986 coincided with increased reform effort by the finance technocrats. The upturn in policy activity is relatively easy to observe, as the finance technocrats were the dominant faction within Cabinet at this time – Yu Kuo-hwa, Robert Chien and Chang Chi-cheng held the key portfolios of Premier, Minister of Finance and CBC governor respectively over most of the period of forex policy change.[87] Of the three, the efforts of Yu and Chang were most pronounced in early to mid 1986: it was Yu who directed the Central Bank to review the administrative provisions for the trade account in May, and Chang who presided over the introduction of the Regulations Governing Foreign Exchange Reporting in Respect of Exports and Imports two months later in July. Robert Chien stepped into the limelight soon after when the Ministry of Finance announced the abolition of the ban on the gold trade in October.[88] It must be noted, that Yu and Chang's early initiatives on the trade front had particularly important ramifications for Taiwan's SMEs. The partial liberalization of the current account saw the elimination of two especially pernicious barriers affecting small exporters: the long-standing trade licensing system and the old *ex ante* application procedure for firms engaged in forex transactions (both of which discriminated in favor of established and larger firms).[89]

As the second KMT policy window opened in late 1986, Yu and his colleagues again increased their reform effort. The greater salience of their policy work at this time is difficult to dispute. Media reports and interviews, for example, place Yu, Chang and Chien at the heart of the decision making process during the crucial months from early to mid 1987 (i.e. the development phase and apex of forex opening). Yu and Chang were directly credited with the launch of the forex reform plan in late March, and the introduction of the new SAFE in July

[87] For a broader appreciation of the tenor of Yu's Cabinet, see: Xue, *Bianju Zhong de Yuejin: Yu Guo-hua de Zhengyuan Wunian* [In the Midst of Critical Change: The Five Year Cabinet of Yu Kuo-hwa], fn. 41, esp. chp. 1

[88] Liu, 'Mounting Forex Reserves Prompt Rethinking of Economic Strategy,' fn. 7; Ke, 'Strength of NT Dollar Bringing Forex Banks to Their Knees,' fn. 8; and *Taiwan Country Report, No. 2, 1987* (London: Economist Intelligence Unit, 1987). Supplemented with interviews in Taipei, 1996 and 1999, esp. interview with Professor Shirley Kuo, Minister Without Portfolio, RoC Cabinet, 4 December 1996.

[89] See: Liu, 'Mounting Forex Reserves Prompt Rethinking of Economic Strategy,' fn. 7; and comments by an unnamed SME proprietor in: *Tianxia Zazhi* [Commonwealth Magazine] (1 June 1986), p. 64-65.

occurred with the official blessing of Chang and Chien.[90] As intimated elsewhere in this chapter, however, the media portrayal of the finance technocrats throughout this period remained overwhelmingly negative: they were believed to be pursuing forex opening under extreme duress and with very little genuine commitment to the task. We will consider the issue of coercion in more depth below, but for now even a cursory look at the historical record reveals that the finance technocrats were far more attached to their reform package than the bad press suggests. Despite the incorporation of the 'logjam clause' into the amended SAFE by the Legislative Yuan in mid June 1986 (as noted in the first section of this chapter) and the loss of executive privilege this move implied, Yu's team choose to proceed with the implementation of the new forex system almost immediately after.[91] This was hardly an act of policy diffidence. Finally, Yu and Chang supervised some of the most important initiatives of the consolidation phase of forex opening. Before the two technocrats retired from office in mid 1989, they authorized the float of the NT dollar in April and the revision of cross-border investment provisions in May.[92]

Second, in addition to the substantive activities considered above, there is evidence that the finance technocrats were conscious of the KMT policy windows that emerged in early and late 1986. On the one hand, forex reform occurred alongside a strong increase in the symbolic commitment of the finance technocrats to small business. At various times over 1986-87, Robert Chien, Chang Chi-cheng and other senior finance officials expressed their sympathy for the SMEs and the hardships endured in light of the rising NT dollar. During the latter phases of forex opening, the finance technocrats also conducted a number of fact-finding missions to communicate with small business on a face-to-face level. On at least one occasion, even Yu Kuo-hwa himself accompanied one of these outings. In early 1989, Yu and Minister of Economic Affairs Chen Fu-an visited a selection of small enterprises in and around Kaohsiung city in southern Taiwan – a region where export oriented SMEs were concentrated and one of the areas worst hit by the currency appreciation of the late 1980s. With these and other symbolic gestures, Yu's technocrats could justly claim to be concerned about the '*zhongxiao qiye shengcun kongjian*' [room to move or breathing space of the island's SMEs].[93] And the

[90] *Far Eastern Economic Review* (9 April 1987), p. 119-120; and *Jingji Ribao* [Economic Daily News] (16 July 1987), p. 1-2. Supplemented with data from: Wang, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [Finance Master: Yu Kuo-hwa's Life and Travels], fn. 26, p. 458-461; and interviews in Taipei, 1996.

[91] *Far Eastern Economic Review* (23 July 1987), p. 53-54.

[92] From: *Tianxia Zazhi* [Commonwealth Magazine] (1 May 1989), p. 86-92. Includes a profile of Chang's time as CBC governor. See also: Xue, *Bianju Zhong de Yuejin: Yu Guo-hua de Zhengyuan Wunian* [In the Midst of Critical Change: The Five Year Cabinet of Yu Kuo-hwa], fn. 41, p. 134-136.

[93] Wang, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [Finance Master: Yu Kuo-hwa's Life and Travels], fn. 26, p. 465; Xue, *Bianju Zhong de Yuejin: Yu Guo-hua de Zhengyuan Wunian* [In the Midst of Critical Change: The Five Year Cabinet of Yu Kuo-hwa], fn. 41, p. 172-174. Further, a review of earlier statements by the Yu group reveals that Taiwan's small business sector rarely attracted their attention before 1986. In the past, concern for Taiwan's SMEs was conspicuously absent during episodes when this group was hurting most. Yu's recollection of the one-off price hike of 1974, and the stagflation of 1981-82 is strictly a macroeconomic account and compares strongly with his interest in the well being of

concern did not go unnoticed. Early feedback from the target group was generally very positive for the technocrats and the ruling party. Toward the end of 1986, SME industry representatives were commenting favorably that '*...zhengfu neng zai zhege shihou fangcong yidian [waihui] guanzhi, bing fudao zhongxiao qiye yinying ye shi henhaode*' [...the government's efforts at this time to loosen exchange restrictions, and give small to medium-sized enterprises a guiding hand to adjust are very welcome indeed].'[94]

On the other hand, there is also evidence demonstrating that Yu's technocrats were aware of the threat to the KMT's finance priorities posed by the inflationary surplus. Above all else, Yu and his colleagues promoted the forex reform process as a fix for monetary policy. As we might expect, this linkage was most pronounced during the developmental phase of forex opening; that is, March to July 1987. When the suspension of forex controls was first announced, Yu issued a press-statement commenting that lifting restrictions on the flow of funds was '...the only way to effectively alleviate the long-term accumulation of foreign exchange reserves and the increase in the money supply.'[95] In presenting the new draft SAFE to the Legislative Yuan several days after, the Premier specified that the Executive Yuan was seeking authority to lift forex controls when Taiwan experienced '...a long-term international trade surplus, accumulated substantial foreign exchange reserves, or when the international economy underwent major changes.'[96] Later, as Chang Chi-cheng attempted to finesse the new law through the Legislative Yuan, the Central Bank governor described the problems faced by the CBC in dealing with the trade surplus. Speaking to the lawmakers in early June, he commented that the CBC's stock of foreign reserves had already reached US$60 billion – an addition of US$3 billion every month since the end of 1986 – and the Bank was doing everything in its power to cope with this monetary influx. He concluded by expressing confidence that the lifting of forex controls would immediately remedy this unstable situation, and called for the expeditious passage of the new SAFE.[97]

And finally, consider the counterfactual question: what if the finance technocrats' reform activities were forced? Within the KMT regime itself, we know that on at least two occasions in mid 1986 and early 1987, President Chiang Ching-kuo spoke directly on the issue of forex policy. In a formal message delivered to Cabinet on 24 July 1986, Chiang appealed for 'action to relax foreign exchange controls, lower tariffs, remove import restrictions and encourage investment abroad.'[98] Nine months later in a ministerial meeting on 14 March 1987, CCK reportedly directed Yu, Chien, Chang and Minister of Economics Lee Ta-hai to speed-up

the SMEs during the late 1980s. See: Wang, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [Finance Master: Yu Kuo-hwa's Life and Travels], fn. 26, p. 268-269 & 273-274; and Ying (ed.), *Juecezhe* [Decision Makers], fn. 39, esp. p. 22-23 & 28.

[94] *Tianxia Zazhi* [Commonwealth Magazine] (1 September 1986).

[95] *Far Eastern Economic Review* (9 April 1987), p. 119.

[96] Liu, 'Brave New World of Financial Reform in Taiwan, the Republic of China,' fn. 6, p. 144.

[97] *China News* (9 June 1987), p. 8.

[98] *Far Eastern Economic Review* (14 August 1986), p. 81.

measures to liberalize and internationalize Taiwan's trade and financial policies.[99] While these episodes certainly demonstrate that CCK had elevated foreign exchange administration to a priority area, they do not imply that he had a plan for change in mind. Indeed, we have strong reason to suspect the opposite. Both communiqués were delivered within the last 18 months of President Chiang's life – CCK's declining health at this time and his long-standing detachment from the details of economic policy[100] must place a question mark over their origins. It is highly unlikely during the last 18 months of his life that the President would have forced Yu Kuo-hwa to pursue a major change in economic policy. We know that over 1986-87, CCK was even more dependent than ever on Yu's economic policy advice. On those rare occasions when Yu did agree to a pursue a policy option not to his liking, he was not afraid to make his position known to the President – witness the decision to lower oil prices over 1986. The intra-elite 'debate' that surrounded this episode was entirely absent in the process of forex liberalization.[101] In sum, detailed pressure for forex reform was not forthcoming from the head of the KMT. CCK's message to the finance technocrats was only slightly more complex than 'review the policy for foreign exchange.'

Aside from any pressure brought to bear by CCK, there is also some evidence of bureaucratic politics playing a part in the finance technocrat's reform activities. At various times in 1986-87, forex reform became a political football in the relationship between the Central Bank and the Ministry of Economic Affairs. Lee Ta-hai from the Economics Ministry was urging a radical adjustment in forex policy (including a large, one-off jump in the exchange rate) to assuage the demands of the Americans for more trade access, while Chang Chi-cheng as CBC governor was heralding the cause of tariff reduction (a key responsibility of the Economics Ministry).[102] But again, as a real source of intra-regime pressure on the finance technocrats, the MoEA and CBC tension is questionable. According to most commentators, Lee's advocacy on the forex issue had more to do with buck-passing than a desire to force the CBC into a policy review. As Minister of Economic Affairs, Lee was the individual bearing the full brunt of American lobbying on the bilateral trade imbalance, and blaming an obstructionist Central Bank probably met with a receptive audience in Washington. Indeed, some of these latter MoEA-CBC exchanges have the feel of a well-rehearsed sympathy play about them – perhaps they

[99] *Far Eastern Economic Review* (26 March 1987), p. 87.

[100] Note related comments in chapter 3, section four on CCK, and see: John C.H. Fei, 'The Taiwan Economy in the Seventies' in Shao-chuan Leng (ed.), *Chiang Ching-kuo's Leadership in the Development of the Republic of China on Taiwan, Volume 3 of the Miller Center Series on Asian Political Leadership* (Lanham, Maryland: University Press of America, 1993), p. 86. See also, personal interview with CCK in *Tianxia* just weeks before his passing. There is not one mention of economic issues in the entire discussion. See: *Tianxia Zazhi* [Commonwealth Magazine] (1 December 1987), p. 17.

[101] Wang, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [Finance Master: Yu Kuo-hwa's Life and Travels], fn. 26, esp. p. 400-411.

[102] *Far Eastern Economic Review* (12 June 1996), p. 128; and *Jingji Ribao* [Economic Daily News] (25 May 1987), p. 1-2.

were orchestrated.[103] Further, why would the Central Bank bow to pressure from the Ministry of Economics at this time? As noted elsewhere, Cabinet was dominated by Yu's finance technocrats throughout 1986-87. Any pressure emanating from Lee and others on the trade issue was unlikely to be decisive.

Outside the KMT regime, there are at least two other 'players' who may have forced the hand of the finance technocrats. To begin with, consider Taiwan's small to medium sized enterprises. As we saw in the last section of the chapter, they certainly had an interest in policy adjustment. And, unlike the middle class investors who we met in chapter 3, they understood their objective interest in reform and were not afraid to raise their concerns in public.[104] However, SME pressure can't explain the sheer extent of assistance they received in conjunction with forex reform – i.e. assistance above and beyond that which could be explained simply in terms of actual enterprise demands. When foreign exchange liberalization reached its apex in July 1987, for example, Yu's Cabinet actively sought to teach small companies how to take advantage of the policy move. At a special seminar conducted soon after the introduction of the new SAFE, the Executive Yuan announced its intention to establish a service center to help small businessmen invest abroad.[105] The service center proposal was just one component of a comprehensive package of SME assistance that had been put in place by Yu and his administrative colleagues by this time. Cobbled together over the preceding 18 months, the support schemes included everything from cheap finance provided by Taiwan's state-owned banks to tax breaks granted by the Ministry of Finance.[106] Forex reform came complete with a user guide and bonus extras for Taiwan's small business sector; no other social group in the RoC was so well looked after.

And finally, the inflation bogey. It could be argued that the inflationary trade surplus was *the* factor pushing reform: that there was no prior existing plan for forex opening, and the finance technocrats were simply backed into a corner by unstable monetary conditions. As briefly noted above, however, it must be remembered that the threat of inflation presented by the trade surplus was just that – only a threat. Despite bubbles in Taiwan's real estate and stock markets at the time, inflation (i.e. a general rise in prices) never eventuated in the late 1980s. Indeed, as of early 1987, a number of ranking economists in Taiwan – including Ke Ji-le, senior economist for the First Commercial Bank, and Yu Zong-xian, second in charge at the Chung-hwa Institute for Economic Research – were confident that *even under existing forex arrangements*, inflation was unlikely to become a major issue in the short to medium term.[107] The saving grace in this story, of course, was the rising NT dollar; this kept a lid on the price of

[103] *Far Eastern Economic Review* (12 June 1996), p. 128; *China News* (6 June 1987), p. 8; *China News* (10 June 1987), p. 7-8; *China Post* (11 June 1987), p. 4; and *China Post* (25 June 1987), p. 7.
[104] *Tianxia Zazhi* [Commonwealth Magazine] (1 October 1986), p. 126-135.
[105] *China News* (14 July 1987), p. 8.
[106] By early to mid 1987, these assistance measures were well institutionalized. See: *Tianxia Zazhi* [Commonwealth Magazine] (1 March 1987), p. 56-60
[107] *Tianxia Zazhi* [Commonwealth Magazine] (1 January 1987), p. 158.

imported consumer goods and production components (note WPI figures on Table 4.7). True, monetary conditions were extremely loose; indeed, sufficient to shake the KMT regime out of its complacency with the old forex system. But there was no desperation in the finance technocrats' decision to liberalize the forex system. It was, to quote Shirley Kuo, '...intentional policy making rather than reactive.'[108]

Conclusion

It has been the argument of this chapter that the process of forex reform on Taiwan in the late 1980s was ultimately driven by the ideas and exploits of the so-called 'finance technocrats,' – a tightly composed group of state officials who owed their allegiance to senior finance administrator Yu Kuo-hwa – and followed a pattern dictated by the short temporal spread of opportunities presented within the ruling party. Foreign exchange liberalization initially got off the ground because the finance technocrats became convinced some years prior to the late 1980s that the internal and external circumstances of Taiwan's economy rendered the old restrictive forex system obsolete. Reform moved from the conceptual stage to policy practice as party political windows of opportunity opened up in quick succession over the course of 1986. In contrast to the case of securities reform that we saw in chapter 3, the temporal spread of opportunities that faced the finance technocrats was extremely narrow – so narrow that they were distinguishable only by a matter of months and in many respects were contiguous. Early into 1986, the finance technocrat's agenda for forex policy change was assured the attention of the KMT regime as it became an effective means of shoring-up party support among small to medium sized manufacturers, a category of traditional party support that was suffering badly from a dramatic rise in the NT dollar exchange rate. Very soon after, the technocrats' reform program received full backing from the KMT because the established foreign exchange system was inadvertently generating an explosion in the domestic money supply; evoking the threat of inflation and therefore a breach of the ruling party's preference for a stable and controllable financial sector. The pattern of foreign exchange opening was decidedly short and sharp because *these two windows of opportunity opened almost simultaneously.*

The chapter was composed of four main parts. In part one I surveyed the process of forex reform as it unfolded between 1986 and 1989. This section focused on the procedural and institutional effect of liberalization rather than the cause. In part two of the chapter we looked behind the outcomes detailed in part one to analyze the root cause. This section included an examination of the composition and ideas of Yu Kuo-hwa's finance team. Part three of the chapter was dedicated to examining the windows of opportunity that emerged within the KMT over the course of 1986-87. In this extended section of the chapter we reviewed why these windows opened when they did. Finally, part four of the chapter considered the response of the

[108] Interview in Taipei with Professor Shirley Kuo, Minister Without Portfolio, RoC Cabinet, 4 December 1996.

finance technocrats to the KMT policy windows detailed earlier. In the next chapter of the study I will explore the process of banking reform that commenced in 1985 and concluded around 1991-92. The pattern of reform in this instance was a hybrid of the two reform episodes we have already reviewed – somewhat faster than the process of securities opening, but certainly not as abrupt as forex reform. Despite the variation in outcomes, however, the banking reform story is strikingly similar to both of these episodes of policy change. We will find that once again a small number of technocrats were at the center of the reform process, and KMT politics was fundamental to the ultimate result.

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-Chapter 5-
Middling through: bank opening from 1985 to 1992

Introduction

For most observers, the introduction of the amended National Bank Law (NBL – *Yinhangfa*) in July 1989 was the jewel in the crown of the island's financial reform agenda, described by one observer in an interview as '...conclusive recognition by the government that the old ways [of financial administration] were not sustainable.'[1] Like most late developing countries and a small number of economically advanced nations, banks had long dominated Taiwan's financial sector. For the majority of RoC citizens and firms, avenues for the disposal of unconsumed income and for raising investment capital were twofold: a dozen or so major commercial banks or the illegal curb market. The character of Taiwan's financial system was in many ways a carbon copy of countries as far distant as Japan, India and Brazil.[2] In Taiwan's case, the simplicity of this financial structure was compounded by state ownership and control of nearly all the banks on the island. While a few regulatory niches were permitted for foreign bank branches and private Trust Companies (a type of non-bank investment firm with many of the hallmarks of monetary institutions), by and large the banking sector was a government monopoly. The portfolio decisions of major concerns like First Commercial Bank, Chang-Hwa, Hua-Nan and the Bank of Taiwan were indistinguishable from the policy directives of the Central Bank of China or the Ministry of Finance. In this context, the decision to liberalize RoC banking had implications that, symbolically as much as practically, went well beyond the reform of securities or foreign exchange. It was here that bureaucratic power over the allocation of funds in Taiwan was most obvious, and it was here that the overall success of financial reform would, rightly or wrongly, ultimately be judged.

In chapter 3 and 4 of the study we saw how the theory of technocrat leadership applied to the case of securities and foreign exchange liberalization. The processes of policy adjustment in those two areas of financial administration were polar opposites: slow and incremental for securities opening, and fast and decisive for forex reform. These differences were indicative of the narrow and wide spread of party political opportunities facing interested technocrats in each case. In the present chapter we will review the case of bank liberalization. In terms of speed and intensity, this episode of financial opening marks out the middle ground between the other two cases of reform. Bank liberalization in the RoC spanned a period of around seven years,

[1] Interview in Taipei with Dr Yin Nai-Ping, Department of Banking, National Chengchi University, 6 July 1996.

[2] On bank-based versus securities-based financial systems, see: Asli Demirguc-Kunt and Ross Levine, 'Bank-Based and Market-Based Financial Systems: Cross-Country Comparisons,' Research Paper No. 2143, Development Research Group, World Bank (July 1999). On financial dualism in late developing countries, see: Jan Pieter Krahnen, *Development Finance as Institution building: A New Approach to Poverty-Oriented Banking* (Boulder: Westview Press, 1994), part C.

while securities reform came in at more than a decade and forex reform took just under four years. Behind the process of bank liberalization, we find that once again the initiative and effort for policy change was tied to a select group of interested technocrats.[3] Bank liberalization was a product of the thinking of the so-called 'young reformers' – a cohort of younger policy elites that included the likes of Shirley Kuo and Wang Chien-shien. These talented and visionary technocrats were motivated by a belief that the local banking sector was grossly inefficient, and that a reformed RoC banking system could one day form the basis of a regional or global financial center. The story of when and how the young reformers were able to act is part of a generalizable account of KMT politics. In chapter 1 of the thesis I argued that for technocrats to be ultimately successful with financial reform, two kinds of 'policy window' need to be open within their referent political party: a broad socio-political window and a narrow sectoral-strategy window.[4] In this chapter, I will demonstrate that the pattern of bank liberalization had features of both forex and securities policy reform because these two policy windows opened neither simultaneously nor discontinuously *but somewhere between these two extremes.* The median spread of opportunities dictated when and how the young reformers were able to act, and ultimately gave rise to a 'middling' process of policy change.

Once again, the present chapter is composed of four main parts. In part one we review the process of bank liberalization. I include an account of the principal steps in the bank reform cycle, and give due attention to the institutional background. In part two of the chapter we look behind the outcomes detailed in part one and seek to analyze causes. This section of the chapter includes an examination of the character and ideas of the young reformers, with a special focus on Kuo and Wang. Part three of the chapter is dedicated to the windows of opportunity that emerged within the KMT over the course of 1985 and 1988. In this section we examine why and how these policy windows opened. In the final section of the chapter, we briefly consider how the young reformers took advantage of the opportunities. We include counterfactual tests to buttress the case for technocrat leadership.

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[3] To recap the definition given earlier in the study: a technocrat is a state official who uses their claim to knowledge in some specialist area, or their ability to perform some specified function, to affirm their right to public office. In this thesis, we use the term with specific reference to 'proximate decision makers,' or elite officials. From: Miguel A. Centeno and Particio Silva, 'The Politics of Expertise in Latin America: Introduction' in Miguel A. Centeno and Patricio Silva (eds.), *The Politics of Expertise in Latin America* (London: Macmillan Press, 1998), chp. 1. See also: Frank Fischer, *Technocracy and the Politics of Expertise* (Newbury Park: Sage Publications, 1990), chp. 1.

[4] It will be remembered from chapter 1 that the socio-political window is generated by a reconfiguration of, or challenge to, the ruling political party's social support base, and the sectoral-strategy window is created by any perceived failure of established financial policy to realize the party's sectoral goals. The notion of the policy window is borrowed from: Jeffrey T. Checkel, *Ideas and International Political Change: Soviet/Russian Behavior and the End of the Cold War* (New Haven: Yale University Press, 1997), esp. chp. 1

1. The process of bank reform

Although the shift in bank policy that occurred during the late 1980s was in many ways just one aspect of Taiwan's broader project of financial liberalization, the course of bank opening had a character that was quite unique (see Table 5.1 for an overview). Bank reform was a mix-match of policy processes – a hybrid of securities and forex policy change. Generally speaking, it encompassed a moderate pace of policy transformation covering some seven or eight years. There is nothing intrinsic to the history of RoC bank regulation that would suggest this process was in some sense inevitable. While the National Bank Law was no stranger to regulatory adjustment prior to 1989, the evolution of the document after its introduction in the 1930s reveals nothing that is even remotely similar to the period we will examine below.

TABLE 5.1 Process of banking liberalization, 1985-92

Phase	*Period*	*Regulatory Initiative*
Takeoff	Mar 1985	CBC announces introduction of prime rate system.
	Jun 1985	Non-bank (trust) institutions given stronger legal basis.
	Jun 1986	EY announces decision to decriminalize bad checks.
Development	Jul 1987	MoF committee convened to review NBL.
	Feb 1988	Review completed; draft NBL handed to EY.
	May 1988	EY approves draft NBL; statute handed to LY.
	Early 1989	Draft NBL debated in LY, some EY concessions.
	11 Jul 1989	LY passes draft NBL; receives EY and Presidential approval.
Apex	19 Jul 1989	Amended NBL comes into effect.
Consolidation	Jul 1989	Interest rate liberalization.
	Mid 1990-	MoF accepts bank license applications; 15 new banks est.
	1989-92-	Some initial progress on bank privatization.

Notes: CBC is the Central Bank of China, EY is the Executive Yuan, MoF is the Ministry of Finance, NBL is the National Bank Law, LY is the Legislative Yuan.
Sources: Various, see esp.: Juan-bao Yan, *Taiwan Diqu Yinhang Fazhan 40 Nian* [The 40 Year Development of Banking on Taiwan] (Taipei: Zhonghua Zhengxinsuo, 1991); Ying-zhao Lai, *Taiwan Jinrong Bantu zhi Huigu yu Qianzhan* [The Domain of Taiwan Finance: Retrospect and Prospects] (Taipei: Lianjing Chubanshe, 1997); and Shang-mao Chen, 'Taiwan Yinhang Zhengce de Zhengzhi Jingji Fenxi' [The Political Economy of Taiwan's Banking Policy], unpublished Masters manuscript, Department of Politics, National Cheng Chi University, Taipei (1998), chp. 2.

The phases of bank liberalization covered the following junctures: the takeoff phase from early 1985 to July 1987, the development phase from July 1987 to June 1989, the apex of reform in July 1989, and the consolidation phase from July 1989 through 1992. In the years prior to reform takeoff, Taiwan's banking system was monist in design and operation. Formal markets for deposits and loans existed only at the margins of the industry, and interest rates offered by the 16 or so domestic banks were set by administrative fiat. Government ownership and control of these institutions came about in progressive stages through the 1940s, 1950s and

1960s. Some were nationalized at the end of the Japanese occupation (e.g. Bank of Taiwan), some followed the government to Taiwan at the end of the Chinese Civil War whereupon state ownership was 'assumed' (e.g. the Communications Bank), and others were established as direct instruments of development policy (e.g. the Medium Business Bank). There were always qualifications of the monist framework: a number of foreign banks were permitted access to the domestic market in the 1960s and early 1980s, and several private Trust Companies were established in the 1970s.[5] While portrayed as major reforms when first introduced, these qualifications were no more than tinkering at the edge of the system. Foreign banks and Trust Companies functioned as little more than satellites of the state-owned concerns, and took their cue on rate changes and business strategy from these institutions.

From the beginning of 1985, however, regulatory changes were gradually introduced that questioned the long-term efficacy of the monist framework. First, in March 1985 the Central Bank announced a partial overhaul of the system of interest rate determination. At that time, a prime-rate system of rate ceilings and floors was adopted to replace the old 'negotiated rate' mechanism.[6] Later, in August 1985, the prime-rate system was entrenched with the abolition of the Statute Governing Interest Rates, the Central Bank's main source of legal authority for dictating rate changes.[7] Second, following a housekeeping revision of the National Bank Law in May 1985, the business rights and obligations of non-bank financial institutions (particularly Trust Companies) were detailed for the first time. While this regulatory move was primarily aimed at curbing the excesses of these institutions, it also served to give private financiers in Taiwan a preliminary legal basis for their operations. Hitherto, non-bank financial institutions had existed in a gray zone. Under Taiwan's civil law code, this was tantamount to a formal prohibition on their operation.[8] And finally, in June 1986 the Executive Yuan announced a

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[5] These points from: Juan-bao Yan, *Taiwan Diqu Yinhang Fazhan 40 Nian* [The 40 Year Development of Banking on Taiwan] (Taipei: Zhonghua Zhengxinsuo, 1991); and Ying-zhao Lai, *Taiwan Jinrong Bantu zhi Huigu yu Qianzhan* [The Domain of Taiwan Finance: Retrospect and Prospects] (Taipei: Lianjing Chubanshe, 1997).

[6] An arrangement that in principle saw rates negotiated among members of the RoC Banker's Association, but in practice was a thin disguise for Central Bank power.

[7] The prime-rate mechanism was basically a system of interest rate ceilings and floors for key or 'prime' financial products offered by banks (e.g demand deposits, call loans, and so on). From: *Financial Market Integration in Chinese Taipei* (Taipei: Bureau of Monetary Affairs, Ministry of Finance, 1995), p. 67-70; and interviews with economists in Taipei, 1996.

[8] Although given mention in the NBL since the 1970s, the management, ownership and business scope of Trust Companies was largely unaccounted for in RoC law. Under civil law jurisdictions like the RoC, business activities must be defined and described to be permissible. Those activities not covered in law are rendered, defacto, either illegal or unprotected by parallel and related legal provisions (e.g. contract law). Interview in Taipei with Lawrence Shao-liang Liu, Attorney at Law, Lee and Li Attorneys, 16 December 1996. The character of Taiwan's legal system left a large inconsistency in the NBL after the amendment of 1975: i.e. Trust Companies were permitted to exist, but left in limbo as to their business rights and obligations. Spelling out more clearly these rights and obligations brought the Trust Companies into the mainstream of RoC financial regulation for the first time, and was a large step in the direction of accepting private banks on the island. For details on the 1985 NBL changes, see: Shang-mao Chen, 'Taiwan Yinhang Zhengce de Zhengzhi Jingji Fenxi' [The Political Economy of Taiwan's Banking Policy], unpublished Masters manuscript, Department of Politics, National Cheng Chi University, Taipei (1998), p. 39-40.

decision to decriminalize bad checks. Post-dated checks were a popular means of extending and obtaining business loans in Taiwan, and were a guaranteed instrument due to criminal prohibitions on non-payment. The effect of their use, however, was to instill a commercial culture among bankers and the business community that was the antithesis of a market oriented financial system; if checks are guaranteed by a prison sentence, why research the commercial wherewithal of a client or customer?[9] The decriminalization of bad checks preempted the introduction of standard credit assessment procedures in Taiwan, and laid the groundwork for more conventional modes of banking.[10]

At around the same time that these major regulatory moves occurred, several other minor reforms were also launched – including the introduction of new bank business powers in the forex market, and the establishment of the Central Deposit Insurance Corporation.[11] It was not until mid 1987, however, that the process of banking reform in Taiwan assumed a coherent direction. Led by the Ministry of Finance, the transition to the development phase of bank opening occurred in the wake of foreign exchange liberalization. At the end of July 1987, the Finance Ministry appointed an internal committee to conduct a review of the National Bank Law. While the timing of the review would seem to suggest it was largely concerned with fine-tuning the NBL,[12] personnel involved in the process saw it as a much more comprehensive endeavor. According to one official from the Ministry of Finance, the review process was '...mainly designed to speed up the internationalization and liberalization of local financial operations.'[13] Over the following six months, the committee completed a summary revision of the Banking Law that included the amendment of 27 existing articles and the inclusion of five new clauses (out of a total of approximately 140 articles).[14] When the draft statute was presented to the Executive Yuan in February 1988,[15] it generated a level of controversy consummate with the document's significance and long-term ramifications. For some, such as

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[9] On post-dated checks, Wade comments: 'The principle instrument in [the Taiwan] financial system is the post-dated check. When a borrower takes a loan he gives the lender a check drawn at some future date for an amount covering principal and interest. In a "normal" developed financial system, by contrast, checks are used as cash substitutes rather than as credit instruments, while promissory notes are used for credit and drafts for trade purposes. In Taiwan, however, the post-dated check is used for all trade finance and is often used as extra security in all kinds of financial transactions. Not only the curb market but also government banks rely on the post-dated check. The basic reason is that the dishonoring of a check carries (since 1954) criminal, not just civil penalties....' See: Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton, New Jersey: Princeton University Press, 1990), p. 162-163.

[10] Philip Liu, 'Bad-Check Decriminalization Has Important Social Implications' in *Financial and Investment Yearbook, RoC 1987* (Taipei: Central Economic News Service, 1987), p. 38-51.

[11] *Taiwan Country Report, No. 2, 1986* (London: Economist Intelligence Unit, 1986), p. 11-12; and http://www.cdic.gov.tw/eng.html [web page of the Central Deposit Insurance Corporation; contains historical notes on the organization] – viewed 22 June 2000.

[12] Another housekeeping revision, this time to keep the NBL in line with the new regulatory framework for foreign exchange.

[13] Willis Ke, 'Liberalization Has Them in a Hopeful Ferment' in *Financial and Investment Yearbook, RoC 1988* (Taipei: Central Economic News Service, 1988), p. 46

[14] CENs staffwriter, 'Draft of Amendments to the Banking Law' in *Financial and Investment Yearbook, RoC 1989* (Taipei: Central Economic News Service, 1989), p. 54-56.

[15] Interviews in Taipei with Ministry of Finance officials and others, 1996 & 1999.

foreign bankers, it was a long-awaited sign that the government was finally getting serious about sector reform. For others – notably representatives from the Taiwan Provincial Assembly – it was a most unwelcome attack on their traditional privileges in the domestic banking sector.[16]

After a brief period of deliberation in the Executive Yuan, in mid May 1988 the draft National Bank Law was endorsed and delivered to the Legislative Yuan.[17] For much of the remainder of the year, the document was held in abeyance as the lawmakers struggled to catch up with a backlog of legislation.[18] During this hiatus, the Ministry of Finance introduced a number of regulatory adjustments keeping the reform momentum afloat. Initiatives included: a program to speed-up the offshore expansion of Taiwan banks, preparation for the entry of commercial banks into the domestic trust business, and the introduction of international credit cards (Visa, MasterCard, etc.).[19] When the National Bank Law finally reached the floor of the Legislative Yuan in early 1989, it rapidly became politicized. Non-KMT representatives (including lawmakers from the newly formed Democratic Progressive Party) made good use of the opportunity to filibuster on a crucial piece of government legislation[20] – a tactic that coincided with a series of opposition street demonstrations.[21] Among the ruling party's own ranks, KMT lawmakers with links to business interests in Taiwan were keen to extract pro-business concessions from the new law. The so-called 'bank legislators' (*yinhang liwei*) lobbied hard on issues such as institutional oversight and the application criteria for new bank licenses.[22] Although the Executive Yuan eventually gave some ground in the face of Legislative Yuan resistance,[23] the ultimate effect on the draft Banking Law was marginal. When the bill was

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[16] *China News* (10 May 1988), p. 4; *China News* (23 May 1988), p. 12; *China News* (27 May 1988), p. 11; and *China News* (28 May 1988), p. 11 & 12.

[17] Occurring sometime between 10 May and 23 May. Deduced from references made in: *China News* (10 May 1988), p. 4; and *China News* (23 May 1988), p. 12. The precise timing of Executive Yuan approval and delivery to the Legislative Yuan is open to some question. At least one writer suggests that the transfer occurred as late as January 1989. See: Yuan-yu Yang, 'San Shangyin Minyinghua yu Xin Yinhang Kaifang Sheli Zhengce zhi Yanbian' [The Evolution of Reform Policy for Privatization of the 3 Commercial Banks and the Establishment of the New Banks], unpublished Masters manuscript, National Chengchi University, Taipei (1995), p. 73. Yang's reference to the timing of these events is inaccurate, and possibly based on an inappropriate reading of related news in: *Gongshang Shibao* [Commerical Times] (6 January 1989).

[18] Recent democratizing moves had generated a strong demand for new enabling laws in the RoC, as well as opening up the legislative chamber to a plethora of new interests and political games; into 1988, the legislative process in Taiwan slowed sharply. More below. Interviews in Taipei, 1996 & 1999.

[19] Various press reports, *Jingji Ribao* [Economic Daily News] (May-December 1988); and *Tianxia Zazhi* [Commonwealth Magazine] (May-December 1988). See esp. interview with Shirley Kuo in *Tianxia Zazhi* [Commonwealth Magazine] (1 September 1988), p. 49-57.

[20] *Taiwan Country Report, No. 3, 1989* (London: Economist Intelligence Unit, 1989), p. 22.

[21] *Far Eastern Economic Review* (1 June 1989), p. 20.

[22] Chen, 'Taiwan Yinhang Zhengce de Zhengzhi Jingji Fenxi' [The Political Economy of Taiwan's Banking Policy], fn. 8, p. 84-85.

[23] *Far Eastern Economic Review* (18 May 1989), p. 56-57; and *Far Eastern Economic Review* (27 July 1989), p. 15.

finally passed on 11 July 1989, key components of the legislation were still intact and congruent with the original purpose of the statute.[24]

The amended National Bank Law rapidly received Cabinet and Presidential approval, and was formally implemented on 19 July 1989. The introduction of the new regulatory framework signified the apex of the banking reform process, and as we saw in chapter 1 of the study, foreshadowed the onset of a new era of more liberal banking in the RoC. Described by more than one observer at the time as 'revolutionary,'[25] the implications of the legal framework went well beyond the sheer number of changes rendered to the text of the NBL (around 25% of the document). Highlights of the new regulatory scheme included: provisions for granting new licenses to an unlimited number of private sector banks, the abolition of remaining restrictions on interest rate mobility, increase of the scope of business operations for foreign bank branches to conditions approaching national treatment, provisions for the privatization of government-owned banks, and institutional reforms designed to enhance prudential oversight and improve the operational health of the Taiwan banking sector.[26] Together, these changes held the potential to instill a far greater level of competition and efficiency into local banking.

In accord with the previous phases of banking reform, the consolidation period of the reform cycle was an exercise in moderation, neither rushed like forex reform, nor meandering like securities opening. The first major initiative in this last leg of the bank reform process was the abolition of the 'prime rate' system of interest rate determination. From 19 July 1989, pursuant to amended article 41 of the revised National Bank Law, rate floors and ceilings were removed and henceforth all products offered by financial intermediaries in Taiwan were subject to variable rates. This reform move had implications for the entire financial system. The introduction of floating interest rates put pressure on those financial prices still subject to administrative fiat – e.g. remaining commission fees on securities transactions – and preempted a compression of margins across the entire financial sector.[27] Another major step in the consolidation phase of bank reform came in mid 1990 when the Standards for the Establishment of Commercial Banks was proclaimed and the Ministry of Finance began accepting applications for new bank licenses. In early 1991, the Ministry granted 15 licenses among a total pool of 19 applicants, and the so-called new banks (*xin yinhang*) commenced business in the second half of the year. Many of the successful candidates were representatives of Taiwan's large industrial groupings (more below), although a 15% cap on proprietary interests de-linked ownership and management of the new institutions.[28]

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[24] *Taiwan Country Report, No. 3, 1989* (London: Economist Intelligence Unit, 1989), p. 22.
[25] Willis Ke, 'Liberalization Continues Sweeping Over Financial Landscape' in *Financial and Investment Yearbook, RoC 1990* (Taipei: Central Economic News Service, 1990), p. 36.
[26] See esp.: *Jingji Ribao* [Economic Daily News] (20 July 1989), p. 1-2; and *Gongshang Shibao* [Commercial Times] (20 July 1989), p. 1-2.
[27] *Jingji Ribao* [Economic Daily News] (20 July 1989), p. 1.
[28] Another half dozen new banks were gradually added to the initial total of 15 by the end of the 1990s. Unlike the first group of licensees, however, these later additions were institutional conversions: most were well-established trust companies or regional cooperatives before they became banks. Chen, 'Taiwan

Finally, some tentative moves were made on privatization of the state-owned banks. The Ministry of Finance had been surreptitiously preparing for privatization since mid 1988. At that time, an intra-government council was convened to decide which administrative agents of the RoC state owned which banks (and how much of each). Soon after the introduction of the amended NBL in July 1989, the Finance Ministry and Central Bank sold their bank equity and commenced negotiation with the other responsible agencies (with a view to encouraging full privatization).[29] The negotiations received a push-along in late 1992 when the National Bank Law was subjected to another round of legislative adjustments. In a move that marks the end of this cycle of bank reform, in October 1992 the Ministry of Finance initiated a cache of minor regulatory changes to broaden the business powers of the new banks and to secure the Ministry's position as the principle regulator of RoC banking.[30] The commercial and administrative repercussions of this regulatory move placed the state-owned banks and their political/bureaucratic overlords under strong pressure to privatize, and set the tone for incremental restructuring over the remainder of the 1990s.

2. The young reformers and the rationale for change

The regulatory and institutional data examined above demonstrates quite clearly that bank reform in Taiwan from 1985 to 1992 was a 'middle of the road' process. The seven-year sequence of change progressed in a manner that was representative of neither panic nor lethargy. Bank opening was a combination of the patterns we observed earlier in the study with securities and forex reform. Those two episodes were respectively sluggish or energetic – adjectives from a continuum of finance policy change which cannot readily be applied to bank liberalization. In staking out the middle ground for finance reform, the process of bank opening probably shares center stage with one or two other key areas of policy development in Taiwan. For example, the wave of RoC labor law reform in the mid 1990s bears some resemblance to the middling pattern of bank policy change.[31] In this respect, the process of bank reform can be understood as a representative sample of the 'average' pattern of policy change in Taiwan. And

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Yinhang Zhengce de Zhengzhi Jingji Fenxi' [The Political Economy of Taiwan's Banking Policy], fn. 8, p. 116. See also: Willis Ke, 'Solid Earnings in a Sea of Economic Turbulence' in *Financial and Investment Yearbook, RoC 1996* (Taipei: Central Economic News Service, 1996), p. 28-31.

[29] The most important of these agencies being the Taiwan Provincial Government – more below. Interview in Taipei with Professor Shirley Kuo, Minister Without Portfolio, RoC Cabinet, 4 December 1996. For the broader context of these initiatives, see also: Chi Schive, 'Experiences and Issues of Privatization in Taiwan' in *Industry of Free China* Vol. 83, No. 1 (January 1995).

[30] *Jingji Ribao* [Economic Daily News] (31 October 1992), p. 1-2; and Chen, 'Taiwan Yinhang Zhengce de Zhengzhi Jingji Fenxi' [The Political Economy of Taiwan's Banking Policy], fn. 8, p. 43-44.

[31] This episode included the decision to bring Taiwan's service industries under the Labor Standards Law. See e.g.: *China Post* (8 May 1996), p. 4; *China Post* (20 June 1996), p. 1; *China News* (2 July 1996), p. 1; and *Jingji Ribao* [Economic Daily News] (7 December 1996), p. 1-2. The evolution of RoC labor law is something of a lacuna in the literature on Taiwan's economic and political development. Considering the close involvement of labor in both movements, it appears strange that labor law hasn't received more attention. The notable exception to this, of course, is the work by Marxist writer Hill Gates in the late 1980s. See: Hill Gates, *Chinese Working-class Lives: Getting by in Taiwan* (Ithaca: Cornell University Press, 1987).

just as the process of bank opening was average in the Taiwan context, so too it appears remarkably middling when compared to other international examples of bank reform. Put side by side with some extreme cases of policy change – say, Poland and Mainland China[32] – the process of bank reform in Taiwan appears decidedly ordinary.

So how can we explain the process of bank reform in Taiwan? As with the previous case studies examined in this thesis, aspects of the bank reform experience can certainly be illustrated with the established theoretical tools of policy science.[33] However, none of these alternatives can clearly explain why bank reform occurred at a median speed and intensity when such a pattern of policy adjustment was by no means inevitable. Further, the theories available in the literature perform especially poorly in explaining certain incongruities in the public perception of bank reform. When reform took off in early 1985 it looked set to become another long and tedious affair like securities opening; and yet, when the amended National Bank Law was finally unveiled in July 1989, it was greeted with all the fanfare of a circus coming to town.[34] How do we explain the fact that the media persona of bank reform was so variable? The reader will recall from earlier chapters that this study seeks to demonstrate a link between financial liberalization and the leadership efforts of elite technocrats. In the first instance, liberalization arises as a conceptual strategy because members of this group decide to adopt a reform agenda and run with it. We will see below that the original motivation for bank reform in Taiwan owed much to the experience and thinking of a younger generation of administrative elites – a group that has occasionally been referred to as the 'young reformers.' These highly talented and ambitious individuals were motivated by two interrelated factors: a belief that Taiwan's banking sector was grossly inefficient and uncompetitive, and a vision that the local financial system could one day compete as a regional or global financial center. This analysis

[32] On the radical process of bank reform in Poland in the early 1990s, see esp.: David Lipton and Jeffrey Sachs, 'Creating a Market Economy in Eastern Europe: The Case of Poland' in *Brookings Papers on Economic Activity* No. 1 (1990). On China's tinkering with its bank system over the 1980s and 1990s, see: On Kit Tam (ed.), *Financial Reform in China* (London: Routledge, 1995); and Xiao-ping Xu, *China's Financial System Under Transition* (London: MacMillan Press, 1998).

[33] The theories include: the market-driven approach, statist analysis, pluralism and the foreign pressures model. See chapter 1, part two. Leading examples of these four theories include, respectively: Richard O'Brien, *Global Financial Integration: The End of Geography* (London: Pinter Publishers, 1992); Louis W. Pauly, *Opening Financial Markets: Banking Politics on the Pacific Rim* (Ithaca: Cornell University Press, 1988); Frances McCall Rosenbluth, *Financial Politics in Contemporary Japan* (Ithaca: Cornell University Press, 1989); and Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca: Cornell University Press, 1994).

[34] Despite the fact that the introduction of the prime-rate system of interest rate determination in March 1985 was an important policy adjustment, it scarcely received any mention in the business press at the time. See e.g.: *Tianxia Zazhi* [Commonwealth Magazine] (March, April & May editions, 1985). When interest rate liberalization was finally taken to its logical conclusion in July 1989, however, press coverage was extensive. Compare: *Tianxia Zazhi* [Commonwealth Magazine] (July, August & September 1989), various articles. See also comments by Shirley Kuo in the September edition of *Tianxia*: 'Zhenzheng de ziyouhua shi shenme ne? Ruguo shuo yuxu mingying, huo zhengfu shenme dou bu guan, jiu renwei shi ziyouhua, zhe shi dada de cuowu.... Women de ziyouhua shouyao zhongdian jiu shi lilu ziyouhua.' [So what is real liberalization? If you say privatization or the complete withdrawal of government involvement, you are sadly mistaken.... The primary object of our liberalization efforts has been the deregulation of interest rates]. *Tianxia Zazhi* [Commonwealth Magazine] (1 September 1989), p. 229.

slowly consolidated in the minds of officials like Shirley Kuo and Wang Chien-shien through the early 1980s, and was well entrenched in their policy outlook as they moved into senior positions of power in the second half of that decade.

The story of when and how the likes of Kuo and Wang were able to pursue policy change is one of KMT politics. I have argued that for elite technocrats to be ultimately successful with financial reform, two kinds of 'policy window' need to be open within their referent political party: a broad socio-political window and a narrow sectoral-strategy window.[35] I will demonstrate below that the pattern of bank reform in Taiwan evolved the way it did simply because, insofar as this sub-sector of finance was concerned, these two windows opened neither simultaneously nor discontinuously *but somewhere between these two extremes*. In a manner that has points of comparison and contrast with both securities and forex opening, the young reformers were confronted with a median spread of opportunities. Early into 1985, the reform agenda of these younger technocrats caught the attention of the KMT regime because it offered a means to deal with the 10th Credit Cooperative crisis, an event which radically undermined the ruling party's preference for a stable and controllable financial sector (sectoral-strategy window opens). Into 1988-89, reform reached its apex and moved to the consolidation phase because it came to be seen as a useful instrument for manipulating and sidelining Taiwan's emerging strata of big business interests (socio-political window opens). The three to four years between these two windows meant that the young reformers were able to promote a considered but timely process of bank reform.

In chapters 3 and 4 of the study we were introduced to the development technocrats (a.k.a the KT Faction) and the finance technocrats (sometimes called the Yu Faction or Yu Family). We saw how these sub-groups within Taiwan's economic technocracy played important leadership roles in securities and forex reform. By and large, bank opening fell to yet another sub-set of policy elites, the 'young reformers.'[36] Unlike the technocrats we have seen elsewhere in this study, the young reformers often saw financial liberalization as a social good in and of itself. As the title suggests, the young reformers were the most market-oriented of Taiwan's technocracy, and were more ideologically driven than their older colleagues. As a group, they were an individualistic network of elites and lacked a readily identifiable mentor. They were not adverse, however, to taking a ride on the back of sympathetic power-holders; the close association of the group with the charismatic Lee Huan has been noted in several academic works and the press.[37] While similar to the development and finance technocrats in basic

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[35] From chapter 1, section three.

[36] This group was called all manner of things in the late 1980s (including the 'young Turks' and the 'NTU faction'), but the title 'young reformers' probably best describes what really defined them – i.e. their generational status in the civil service and their policy orientation. See for example: *Far Eastern Economic Review* (28 July 1988), p. 19.

[37] Cong-rong Li, 'Guojia yu Jinrong Ziben: Weiquan Shicong Zhuyi xia Guomindang Zhengquan Yinhang Zhengce de Xingcheng yu Zhuanxing [The State and Financial Capital: KMT Bank Policy Form and Development under Authoritarian Rule] unpublished Masters manuscript, Department of Sociology,

composition and thinking (review arguments in chapter 2, section three), the young reformers differed from these two sub-groups in several important ways. They were distinguishable as technocrats who: (1) were too young to have had adult or professional experience of KMT rule on the mainland, (2) had advanced academic credentials, often at the PhD level and often including extended periods as a college professor, and (3) tended to bypass career appointments in Taiwan's state-owned enterprises in favor of promotion through the bureaucracy. As a general 'type' of technocrat, the young reformers are difficult to place in any broad category presented within the literature. This said, the strong political sensibilities of the group would seem to suggest that they had a natural affinity with Williamson's concept of the 'technopol.'[38]

This mix of technocratic skills and political smarts saw some young reformers follow a career path that eventually lead to formal politics. After first making a name for themselves as ranking economic policymakers, individuals like Wang Chien-shien (more on him below) and Vincent Siew gained seats in the Legislative Yuan as candidates for the KMT. There are tentative parallels here with the career paths of some Japanese civil servants in the post-War era (through Japan's line-ministries to the Diet).[39] However, for most young reformers the career path of choice was, perhaps ironically, deeply inspired by Chinese tradition: a path leading from scholarship to civil service and back again. Some of the leading exponents of this classical journey included such individuals as Fredrick Chien (younger brother of Robert Chien who we met in the last chapter), Chen Li-an and Shirley Kuo (more below). These three young reformers were particularly impressive individuals. Over and above their achievements in the RoC bureaucracy, they were among Taiwan's foremost scholars in the fields of international relations, mathematics and economics respectively. This strong formal link with the academy was backed up by a host of particularistic links. In contrast to the technocrats we have seen in previous chapters, the young reformers thrived on being seen to mix with Taiwan's intellectual elite. While the development technocrats had eclectic relationships with Taiwan's academic community and the finance technocrats choose to ignore them almost completely, the young reformers saw ongoing dialogue with professors from Taiwan's elite universities as both natural and healthy.[40] Ties to the Department of Economics at National Taiwan University and the Chung-hua Institute of Economic Research (a semi-autonomous offshoot of NTU) were

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Tunghai University, Taiwan (1994), p. 108. See also: *Far Eastern Economic Review* (1 June 1989), p. 20.

[38] See: John Williamson (ed.), *The Political Economy of Policy Reform* (Washington: Institute for International Economics, 1994), chp. 1.

[39] There is a well-developed academic debate regarding who pulls the strings in Japan's 'lateral' transfer of personnel from the bureaucracy to the legislature. For the party-political argument, see: Mathew D. McCubbins and Gregory W. Noble, 'The Appearance of Power: Legislators, Bureaucrats and the Budget Process in the United States and Japan' in Peter F. Cowhey and Mathew D. McCubbins (eds.), *Structure and Policy in Japan and the United States* (New York: Cambridge University Press, 1995). For the bureaucratic argument, see: Chalmers Johnson, 'Japan: Who Governs? An Essay on Official Bureaucracy' in *Journal of Japanese Studies* Vol. 2, No. 1 (Autumn 1975).

[40] Confirmed in interviews with Wang Chien-shien and Shirley Kuo. Interview in Taipei with Professor Shirley Kuo, Minister Without Portfolio, 4 December 1996; and interview in Taipei with Mr Wang Chien-shien, Chairman, the Renewal Foundation, 9 July 1999.

particularly well established, links which were partially responsible for the group occasionally being dubbed 'the NTU gang' (*Taida bang*).

The fact that the young reformers' lacked a readily identifiable mentor makes it quite difficult to isolate the core of the group. This said, it is possible to name at least two technocrats whose absence from an inventory of key players in banking reform would leave such a list incomplete: Shirley Kuo and Wang Chien-shien. Of these two individuals, Shirley Kuo (*Guo Wan-rong*) stands out as the intellectual principal. The first twenty years of Kuo's professional life were centered on various academic appointments and study at the Department of Economics, National Taiwan University. After graduating with a bachelor's degree in the early 1950s, Kuo immediately took up a position as an associate lecturer in the Department. Over the following decade she augmented her qualifications with a Masters degree from MIT (1962-63), and soon afterward was appointed full professor (1966). The next seven years were some of Kuo's most productive academically,[41] culminating in her selection as a Fullbright-Hays Exchange Professor to MIT in 1971-72. Her transition from academic life to public service occurred in 1973 and was almost seamless, rendered possible by a senior appointment to the research oriented Council for Economic Planning and Development. During the next six years she caught the attention of finance heavyweight Yu Kuo-hwa (who we met in chapter 4) and was promoted to the position of Deputy Governor of the Central Bank in 1979. From 1979 to 1988 Kuo worked closely, though not uncritically, with Yu while studying for a doctorate in economics at Kobe University. The completion of this degree in 1984 marked the pinnacle of her academic career[42] and laid the way for her appointment as Minister of Finance in July 1988. Kuo's three years as Finance Minister coincided with the passage of the amended National Bank Law and presaged some of the most important changes in Taiwan's banking sector for 40 years. During this period, her personal influence in policy-making circles reached its zenith – a fact officially confirmed with her concurrent ascendancy to the Central Standing Committee of the KMT.[43]

If Shirley Kuo was the brains trust of the young reformers, Wang Chien-shien (*Wang Jian-xuan*) was the group's publicist. A natural self-promoter and purveyor of new policy ideas, Wang commenced his career in 1961, graduating with an arts degree (statistics major) from

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[41] And included the production of a number of works in English and Chinese, including: Shirley W.Y. Kuo, *The Economic Structure of Taiwan, 1952-1969* (Taipei: Graduate Institute of Economics, National Taiwan University, 1970).

[42] While studying for her doctorate at Kobe, Kuo concurrently produced three English texts on RoC economic development for which she is best known outside Taiwan: John C.H. Fei, Gustav Ranis and Shirley W.Y. Kuo, *Growth With Equity: The Taiwan Case* (New York: Oxford University Press, 1979); Shirley W.Y. Kuo, Gustav Ranis and John C.H. Fei, *The Taiwan Success Story: Rapid Growth with Improved Income Distribution in the Republic of China* (Boulder: Westview Press, 1981); and Shirley W.Y. Kuo, *The Taiwan Economy in Transition* (Boulder: Westview Press, 1983).

[43] Biographical material from: *Republic of China Yearbook, 1996* (Taipei: Government Information Office, 1996), p. 506-507; and *Zhonghua Minguo Mingrenlu, Minguo 88 Nian* [Who's Who in the Republic of China, 1999] (Taipei: Central News Agency, 1999), p. 162-163. Supplemented with information from interview in Taipei with Professor Shirley Kuo, Minister Without Portfolio, 4 December 1996.

National Chengkung University. He soon after commenced a research Masters in finance at National Chengchi University, during which time he developed an interest in public administration and fiscal policy. Completing his Masters in 1965,[44] Wang stayed on as an associate lecturer at Chengchi University and refined his academic interests to taxation. This narrowing of research concerns eventually took Wang to the US, where in 1971 he was admitted as a fellow in the International Taxation Program of Harvard's Center for International Affairs. Upon returning to Taiwan in the following year, Wang took up a post as research specialist in the Department of Taxation, Ministry of Finance. In the ensuing decade and a half, he moved from post to post in the Finance Ministry and the Executive Yuan – mostly at the level of divisional director – developing a reputation for thoroughness and 'straight talking' in the process.[45] At the end of this period, Wang finally got the promotion he needed to place him among Taiwan's most senior technocrats: in 1984 he was appointed Administrative Vice Minister of Economic Affairs, a post he held until 1989. After a brief period as Political Vice Minister of Economic Affairs, Wang was appointed Minister of Finance in 1990. As Finance Minister from 1990 to 1992, Wang Chien-shien was closely associated with the introduction of the new private banks, and other initiatives of the bank reform 'consolidation phase.' These events saw our young reformer honored as the 1992 Asian Development Bank Finance Minister of the Year and named by the Executive Yuan for the rare Distinguished Services Award.[46]

The young reformers were destined from the very start of their careers in government service to be the ideational engine of bank opening. Their reasons for seeking reform in this most prominent area of financial administration were basically twofold. On the one hand, the young reformers believed that Taiwan's banking sector was grossly inefficient and uncompetitive. Comments by Wang Chien-shien in an interview make this point eloquently and succinctly, and are worth quoting in full:

> 'When I first became vice-Minister of the Economics Ministry I heard petitions and complaints almost every month about the poor state of the financial sector. The state-owned banks in particular would receive a lot of criticism. Most of this was quite justified: the outrageous difference between loans and deposits at the state banks, for example, meant that they were simply not interested in improving their service to

[44] See: Chien-shien Wang, 'Faren Suodeshui Wenti zhi Yanjiu' [A Study on Corporate Income Tax Problems] unpublished Masters manuscript, Finance Research Center, National Chengchi University, Taipei (1965).

[45] See for example: Chien-shien Wang, *Suodeshui Zhidu ji Shifu* [A Thorough Account of the Income Tax System] (Taipei: Public Finance Training Institute, Ministry of Finance, 1977); and Chien-shien Wang, *Shuiwu Kuaiji* [Tax Accounting] (Taipei: Huashi Wenhua, 1981).

[46] Biographical material from: *Shijie Nianlu 1996* [Chinese World Almanac 1996] (Taipei: Central News Agency, 1996), p. 925; and *Republic of China Yearbook, 1996*, fn. 43, p. 568-569. Supplemented with information from interview in Taipei with Mr Wang Chien-shien, Chairman, the Renewal Foundation, 9 July 1999. As alluded to above, Wang Chien-shien made a move to politics in the early 1990s after completing his tenure as Minister of Finance. In this period, Wang's natural inclination toward advocacy and reform (broadly defined) became most apparent. See, in particular: Chien-shien Wang, *Rang Haoren Chutou: Wang Jian-xuan de Congzheng Linian* [Let Good People Rise: Wang Chien-shien's Political Thinking] (Taipei: Commonwealth Magazine Publishers, 1995).

customers and clients. Before banking reform it was a seller's market – they were extremely lazy in some areas. When I became Finance Minister, for example, I asked one of my subordinates why the money market was so thoroughly monopolized by the three Bills Finance Companies when banks *were* permitted to do some kinds of business in this area. He replied that they were simply not interested. They were already making unreal profits in the banking business, *why would they want to diversify*?!'[47]

With more than half of all deposits at RoC monetary institutions in the early to mid 1980s going to the 16 government banks (including the entire pool of government deposits), they could afford to be extremely lazy about attracting funds. On the demand side, they satisfied greater than 70% of the market for loans in Taiwan; there was absolutely no incentive to seek-out new corporate or consumer custom.[48] But this inefficiency was even more insidious than the broad figures suggest. Wang Chien-shien continues:

'The way corporate banking was conducted was also very uncompetitive. To get funds from a bank, businessmen almost always needed to have a "special" relationship with their bank manager; this often involved all sorts of bribes and quasi-legal "fees." The extent of this bad business practice and the poor state of corporate banking in Taiwan was especially underlined by the comparative performance of the new foreign banks in the local market [NB. many of these institutions arrived in the early 1980s]. They were totally different in their approach to doing banking business, and they made the domestic banks look really bad in a number of areas. The treatment of businesswomen in Taiwan was a case in point – the domestic banks virtually ignored women completely, but the foreign banks tapped into this lucrative market very early. Examples like this made it obvious that reform of the banking sector was required. And reform did make a dramatic difference: before liberalization businessmen would go to their bank for funds; after reform bank, managers would actively go out and visit company clients. Almost overnight banking became a buyer's market.'[49]

On the other hand, the young reformers had a vision for the future role of Taiwan's financial sector in the national economy. This thinking was a logical extension of the policy agenda first advanced by the development technocrats in the late 1970s (as outlined in chapter 3, section two), and was cast within a discussion on Taipei's emergence as a major center for banking and finance. In the past, the young reformers reasoned, Taiwan had performed very well with manufacturing, but this component of GDP – around 50% in the mid 1980s – would eventually

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47 Emphasis in original discussion. Interview in Taipei with Mr Wang Chien-shien, Chairman, the Renewal Foundation, 9 July 1999.

48 Calculated from statistics in: *Zhonghua Minguo Taiwan Diqu Jinrong Tongji Yuebao* [Financial Statistics Monthly, Taiwan District, Republic of China] (Taipei: Economic Research Department, Central Bank of China, July 1986), esp. sections on consolidated assets and liabilities of banks, all monetary institutions and 'other' financial institutions.

49 Interview in Taipei with Mr Wang Chien-shien, Chairman, the Renewal Foundation, 9 July 1999.

shrink and become less important as a source of national growth. Some time in the medium to long term, Taiwan's rising cost structure and increasing volume of real trade (among other things, trade stimulates financial activity as financial institutions facilitate payments, provide letters of credit, etc.) would favor the island's emergence as a service-led economy. [50] Eventually, Taiwan would become 'post-industrial' in the same manner as Europe and North America in the late 1960s, with the finance sector at the forefront of the change.[51] To provide a conceptual framework for this transition, the young reformers sought to portray Taipei as a potential site for regional and international banking business. Following important historical works by Kindleburger and Reed,[52] the notion of the financial or banking 'center' became popular in RoC academic circles during the early to mid 1980s. Although Taiwan's tight regulatory structure was a strong barrier to entering the global network of transaction centers, Taipei had a number of other things going for it: basically sound monetary institutions, geographical proximity to the markets of China and North East Asia, a strong industrial base, a strong trade position, an educated workforce and (at least as applied to the commercial sector) an established tradition of legalism.[53] With the right infrastructure and regulatory opening, Taipei could reinvent itself as the next Hong Kong or Singapore – and complete the cycle of developmental catch-up in the process.[54]

These two specific reasons for seeking bank liberalization dovetailed with the young reformers' broader outlook on social policy and political development. Although it would be wrong to portray this group of policy elites as diehard democrats – indeed, occasionally it seems the reverse was true – there is little question that they saw bank reform as something bigger than simply an adjustment of regulatory provisions. The essential 'embeddedness' of their reformist agenda was apparent in interviews. In response to a question about her motives for bank reform during her time as Finance Minister, Shirley Kuo comments that liberalization is often defined far too narrowly. She continues:

> 'We must first understand what we mean by liberalization. Financial liberalization has three main aspects: the deregulation of prices so that they may reflect scarcity, the removal of restrictions on the movement of funds and the liberalization of management.

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[50] Interviews in Taipei, 1996 and 1999. I am especially grateful for a discussion with Timothy Lin, Senior Counsel to the Chairman, Securities & Exchange Commission, Ministry of Finance, 5 March 1996.

[51] To use a term first coined by Bell: Daniel Bell, *The Coming of Post-Industrial Society: A Venture in Social Forecasting* (New York, Basic Books, 1978).

[52] Charles P. Kindleberger, *The Formation of Financial Centers: A Study in Comparative Economic History* (Princeton: Princeton University Press, 1974); and Howard C. Reed, *The Preeminence of International Financial Centers* (New York: Praeger Publishers, 1981).

[53] Interviews in Taipei, 1996 and 1999.

[54] To some extent, the launch of the 'offshore banking units' or OBUs in mid 1984 (as noted in chapter 4, section one) was a tentative step toward this goal. See: Michael A. Goldberg, 'International Finance on the Pacific Rim and the Emerging Network of Pacific International Financial Centers' a paper presented to the 21st World Congress of the International Association of Financial Executives Institutes, International Convention Center, Taiwan (4-7 November 1990), p. 36-37. In practice, this item of regulatory tinkering held more implications for forex regulation than banking. For this reason, I have included detail on the OBU scheme in chapter 4 rather than here.

It is not just an economic phenomenon, as many academic economists would argue, but also a social and institutional phenomenon as well. As financial liberalization progresses, people have to get use to it and make adjustments. For this reason the pace and style of liberalization is important, not just the end goal.'[55]

Of the three groups of technocrats examined in this study – i.e. the development technocrats, the finance technocrats and the young reformers – the last were the most sensitive to the broader implications of their policy agenda. The young reformers were far more attuned than their colleagues to the social dynamics and context of financial opening; a fact they used to their advantage when it can time to winning over the powers that be within the KMT.

3. The KMT policy windows for bank reform, 1985 and 1988

Of course, at the time (and indeed, long after), many observers hotly disputed the arguments for bank liberalization advanced by Shirley Kuo, Wang Chien-shien and others. Some bureaucrats and many state-bank employees argued that the measures of efficiency applied to Taiwan's domestic banks were inappropriate. Contrary to the claims of the young reformers, supporters of the status quo believed that the banks *were* efficient – as revealed by research based on assessment criteria relevant to public sector enterprises.[56] The young reformers also came under fire for advancing the idea that Taiwan's economy could one day ride on the back of the finance industry. Opponents of change believed that the banks' primary role in the Taiwan economy was to support manufacturing and would remain as such indefinitely[57] – the notion that Taipei could emerge as a center for regional or international transactions, they argued, was simply a delusion. Despite the conceptual and practical pitfalls of these arguments, they had considerable currency in Taiwan prior to the commencement of bank reform in the mid 1980s. To a significant extent, this popularity was an indirect function of the party political realities of the time. Bank liberalization would never be a policy option for the island unless it could

[55] Interview in Taipei with Professor Shirley Kuo, Minister Without Portfolio, 4 December 1996.

[56] For example: 'It really depends on how you measure efficiency. We have done comparative studies on the performance of government-owned banks and foreign private banks in Taiwan and found that in terms of return on assets (RoA), Taiwanese banks perform as well as or even better than the foreign banks. On the other hand, in terms of return on expenditure (RoE) the foreign banks outstrip Taiwan's government banks every time. This is to be expected, however, because for various reasons they have higher leverage ratios.' Interview in Taipei with Chang Ming-daw, Director, Division of Domestic Banking, Bureau of Monetary Affairs, Ministry of Finance, 2 April 1999. This argument could be seen as a post-modern deconstruction of the concept of 'efficiency.' The bottom line is that in most countries most of the time, *markets* reward banks that get a good return on their outlay. While it is true that efficiency is a multifaceted beast, searching for a definition that best suits your opinion is simply spurious.

[57] The idea that the financial system in Taiwan preformed a supporting role vis-à-vis manufacturing in the island's development process is enduring but essentially erroneous. The point was well made in an interview with Lawrence Liu: 'Manufacturing in Taiwan has never been happy with the state of the financial industry here. It is nonsense to suggest that the financial industry could somehow serve manufacturing when so many companies resort to the curb market or go overseas to satisfy their financial needs.' Interview in Taipei with Lawrence Shao-liang Liu, Attorney at Law, Lee and Li Attorneys at Law, 16 December 1996.

impress the ruling KMT as an expeditious strategy (1) to secure socio-political support, and (2) to reinforce the party's conservative finance goals.

Early in 1985, however, the second of these windows of opportunity opened and set the stage for bank reform. The source of the KMT's change of heart was the 10th Credit Cooperative scandal (*Shixin fengbao*), named after a financial subsidiary of the Cathay conglomerate as the first enterprise in the group to attract government intervention. Academic and industry commentators have described the 10th Credit Cooperative scandal as the worst economic crisis in Taiwan's post-War history.[58] Three separate government reports conducted after the event outlined a long record of funds misappropriation within the Cathay business group, and a trail of administrative indecision by the RoC monetary authorities. At the end of play, private machinations and public incapacity led to a total of NT$7.7 billion (US$190 million) of blatantly illegal loans being 'lost' within the Cathay group, NT$20 billion (US$500 million) in suspect loans turned over to bad debt, and an additional NT$3.3 billion (US$85 million) in public funds devoured in the process of trying to rectify the mess. Further, a series of runs on affiliated Cathay group enterprises nearly brought down the entire conglomerate and threatened a general loss of faith in RoC financial institutions. Economists have estimated that Taiwan's GDP growth in 1985 was probably reduced by around 0.5-1% as a direct result of the 10th Credit Cooperative scandal. In the search for blame, a score of Cathay group executives were convicted of fraud and imprisoned, and three senior members of the Executive Yuan were 'retired' from their posts.[59]

To really appreciate how all this transpired, it is first necessary to consider a basic conceptual question in bank regulation: How are banks distinguished from other financial intermediaries?[60] In theory, banks are those intermediaries that by virtue of their authority to accept demand deposits and provide call loans *create money*.[61] This specific power places these

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[58] *Tianxia Zazhi* [Commonwealth Magazine] (1 April 1985), p. 61; and Karl J. Fields, *Enterprise and the State in Korea and Taiwan* (Ithaca: Cornell University Press, 1995), p. 170.

[59] Figures and comments from: *Far Eastern Economic Review* (21 March 1985), p. 150-153; and *Far Eastern Economic Review* (12 September 1985), p. 93-94.

[60] It will be recalled that in the introduction, we defined financial intermediaries as institutions that issue indirect financial instruments (deposits, insurance contracts, etc.) and in turn lend or invest the accumulated funds. See: Brian Wallace Semkow, *Taiwan's Financial Markets and Institutions: The Legal and Financial Issues of Deregulation and Internationalization* (Westport: Quorum Books, 1992), p. 32-33.

[61] A few words on the mechanics of money creation by banks is probably warranted here. Assume a closed economy with one bank and one customer – a builder who we'll call 'Ned.' Assume further, that money is defined as currency in circulation plus bank deposits (sometimes referred to as M1A). Ned has placed his life savings totaling $10,000 in the bank. As the bank only has one customer, this means that it has deposit liabilities to the value of $10,000. To transport more materials and tools to his latest worksite, Ned needs a bigger pick-up truck. He approaches the bank, which lends him $10,000 (he's a good customer), which in turn he then uses to purchase a truck worth $8,000. Ned places the remaining $2,000 into his savings account – a reserve he'll retain for upkeep on the car. This addition to Ned's original savings means that he now has $12,000 in the bank, and the bank has $12,000 in deposit liabilities. This transaction has meant that the stock of money in our closed economy has increased by $2,000. The bank has *created money*. While this model is obviously a simplification – indeed, our model gives no indication of how liquidity is maintained in a financial system – in reality the principle is more or less the

institutions in a unique position. They are an integral link in a nation's payments system (i.e. the system of currency and exchange which facilitates economic transactions) and, together with reserve bank management decisions, play a key role in determining an economy's volume and velocity of money. The unique function of banks directly ties their corporate activities with the public good – a fact that is generally accepted as justification for regulating banks more closely and more strictly than other enterprises. So-called 'non-banks' are financial intermediaries that do not have the authority to accept deposits and provide loans – or if they do, these rights are strictly qualified – and therefore *cannot create money.* The category includes insurance companies, venture capital companies, credit cooperatives, and trust and investment firms. The last two of these financial institutions are widely used in many developing financial systems (largely due to their organizational simplicity), and were an integral part of Taiwan's financial landscape by the mid 1980s. They perform an important function in a financial system by competing with banks for scarce funds, and are usually granted access to riskier markets. In principle, however, their business activities do not have an impact on a nation's payments system.[62] Although the distinction may be clear in theory, in practice keeping banks and non-banks apart can be a major headache for monetary authorities. Unsupervised, non-banks can easily 'slip' into deposit taking and loans provision, or become entangled in various interbank transactions. In turn, this can become an issue for monetary administration and the health of the financial system – particularly if the non-banks concerned are large and engaged in business activities where the risk of moral hazard is high.[63]

From the very beginning of KMT rule on Taiwan, the regime permitted a small cohort of private non-bank intermediaries to do business. Based on the assumption that banking functions could be readily sealed off from these financial institutions, the ruling party saw their inclusion in the regulatory framework as consistent with its goals of stability and control. Credit cooperatives (*xinyong hezuoshe*), including credit departments of industry associations, became active in the 1950s as the KMT regime pursued land reform and restructured the island's agricultural sector. They performed functions well beyond the mobilization and provision of credit for members, including the administration of industry extension services, regional developmental financing, and financial training and education for local government officials. As noted in chapter 2 of the study, the credit cooperatives attracted considerable low-level fraud

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same. Based on observations in: John Zysman, *Governments, Markets, and Growth: Financial Systems and the Politics of Industrial Change* (Ithaca: Cornell University Press, 1983), p. 59-60.

[62] Dimitri Vittas, 'The Role of Non-Bank Financial Intermediaries (with Particular Reference to Egypt),' research paper prepared for the World Bank, Working Paper No. 2325 (April 2000), available online at http://www.worldbank.com/ [web page of the World Bank Organization] – viewed on 20 August 2001.

[63] On the problems of non-banks, see: Anjali Kumar, Nicholas Lardy, William Albrecht, Terry Chuppe, Susan Selwyn, Paula Perttunen and Tao Zhang, *China's Non-Bank Financial Institutions: Trust and Investment Companies, World Bank Discussion Paper No. 358* (Washington: World Bank, 1997). Moral hazard is usually defined as a problem of information asymmetry in contracts (e.g. a dying man takes out life insurance, lying about his condition to obtain a large payout for his family after his death). For a taxonomy of the various manifestations of moral hazard, see esp.: Eric Rasmusen, *An Introduction to Game Theory*, 2nd ed. (Cambridge, MA: Blackwell, 1989), chp. 7-10.

and corruption. Local political elites regularly used the island's 350-400 cooperative institutions to bankroll regional election campaigns and fund private construction projects. However, the credit cooperatives were only ever a minor part of Taiwan's financial system; even by the early to mid 1980s they accounted for less than 10% of the total pool of national savings.[64] Content that the credit cooperatives had proven to be relatively innocuous, in the early 1970s the KMT regime permitted the introduction of another kind of non-bank institution – trust and investment companies (*xintuo touzi gongsi* – TICs). The TICs were a fairly painless way for the ruling party to satisfying demands for more private participation in the financial sector, while leaving the state-owned commercial banks largely untouched. Six licenses were issued in 1971, establishing the following firms: Cathay Trust, the Overseas Trust Corporation, Taiwan First, the United China Trust Company, Asia Trust and the Taiwan Development Corporation. Although the TICs were married to some of Taiwan's larger business groupings, their activities were firmly constrained. New regulations on insider trading introduced in 1975 left it in little doubt that they were never intended as piggy-banks for Taiwan's emerging conglomerates.[65]

But although the KMT regime saw the credit cooperatives and trust companies as a harmless adjunct to the state-owned banks, at least one entrepreneur had grander plans for his non-bank institutions. Tsai Wan-chun founded the Cathay group with his brothers in the early 1950s, doing business in a variety of areas including food processing, retail, lumber and real estate. Keen to tie Cathay's long-term expansion to the service industry, in the late 1950s Tsai took over management of the 10th Credit Cooperative Association of Taipei. This move presaged two decades of rapid growth for the group and further diversification into as many areas of the financial business as the government would (progressively) allow. By 1977, Cathay encompassed 24 separate enterprises, consolidated assets of US$1 billion (more than 4% of Taiwan's GDP) and around 20,000 employees – one of the largest industrial groups in Taiwan at that time measure in terms of assets. It also included two insurance companies, a large leasing operation run as an appendage to the group's construction business, and the Cathay Investment and Trust Company (*Guotai Xintuo Touzi Gongsi*, founded in 1971). Over the course of the 1970s, the Cathay group's finance arm pursued business activities that

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64 Ming-hui Wang, 'Cong Wanglu Guanxi Tantao Nonghui Xinyongbu zhi Yunzuo' [A Network Analysis of the Use and Manipulation of Credit Departments in Farmers Associations] in *Si yu Yan* [Ideas and Words] Vol. 31, No. 2 (June 1993); and Chyuan-Jeng Shiau, 'The Functions and Development of the Farmers Associations in the Republic of China' in *Journal of Social Science* Vol. 34 (June 1986). For an in-depth review of local financial institutions from a more sociological perspective, see: Bao-an Lin, 'Taiwan Difang Jinrong yu Difang Shehui: Xinyong Hezuoshe de Fazhan Lishi yu Shehui Yiyi' [Local Finance in Taiwan and Local Society: The Development and Social Significance of Credit Cooperatives], unpublished Ph.D. manuscript, Donghai University, Taiwan (1994).

65 Tun-jen Cheng, 'Guarding the Commanding Heights: The State as Banker in Taiwan' in Stephan Haggard, Cheng H. Lee and Sylvia Maxfield (eds.), *The Politics of Finance in Developing Countries* (Ithaca: Cornell University Press, 1993), p. 70-71; and Nai-ping Yin, '40 Nian lai Taiwan de Jingji Fazhan yu Jinrong Zhengce' [40 Years of Economic Development and Financial Policy in Taiwan] in *Ziyou Zhongguo zhi Gongye* [Industry of Free China] Vol. 70, No. 4 (October 1991), p. 19.

occasionally pushed the envelope of Taiwan's financial law. Between 1974 and 1979, the 10th Credit Cooperative was cited four times by the island's monetary authorities for accepting irregular deposits. Due to inadequate legal provisions, each infraction incurred little more than a reprimand. In addition, the Tsai family was implicated in a number of untoward business deals. One involved a speculative venture in which Cathay Life and Cathay Trust equity was secretly used to leverage a real estate purchase. Government investigations revealed insufficient evidence to prosecute.[66]

TABLE 5.2 Tsai family and the structure of the Cathay conglomerate

Family Member	*Relationship to Tsai Wan-chun*	*Cathay Group Subsidiary*	*Main Areas of Business*	*Sample Companies*
Chen-chou	elder son	Cathay Plastics Group	petrochemicals, manufacturing	Cathay Plastics, Taiwan Shoes, 10th Credit
Chen-nan	elder son	Cathay Trust Group	finance, services, manufacturing	Cathay Trust, Lai Lai Hotel, Cathay Electric
Wan-tsai	brother	Fubon Group	construction, finance,	Fubon Investment, & Construction
Wan-lin	brother	Lin Yuan Group	construction, finance, services	Cathay Construction, & Life Insurance
Chen-yang, Chen-wei	younger sons	Hsing Lai Group	services	Lai Lai and Hsing Lai Depart. Stores

Sources: *Tianxia Zazhi* [Commonwealth Magazine] (1 April 1985), p. 68-69; and Karl J. Fields, 'Developmental Capitalism and Industrial Organization: Business Groups and the State in Korea and Taiwan' unpublished Ph.D. manuscript, Graduate Division of Political Science, University of California at Berkeley (1990), chp. 5.

In 1979, ill health persuaded the elder Tsai Wan-chun to break-up his family company into five nominally independent operations headed up by his two brothers and four sons (see Table 5.2). Taking advantage of poor administrative oversight and the emerging market power of the Cathay conglomerate (with total assets of US$3.7 billion by 1984), the eldest sons Tsai Chen-chou and Tsai Chen-nan used Cathay Plastics and Cathay Trust to fund speculative business ventures and support their extravagant lifestyles. Initially these money games were relatively

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66 *Tianxia Zazhi* [Commonwealth Magazine] (1 April 1985), p. 61-75; Fields, *Enterprise and the State in Korea and Taiwan*, fn. 58, p. 172-174; and historical information from several Cathay group web pages, including: http://www.cathaysite.com.tw/ [website of the Cathay Securities Investment Trust Company] – viewed 24 August 2001.

inconsequential, but when the economy floundered in 1981 they took an ominous turn. With Cathay sales down and profit margins trimmed, the group's overall repayment ability was seriously compromised. Cathay Plastics in particular began to struggle, and at some point Tsai Chen-chou started to plunder the funds of the 10th Credit Cooperative to prop-up the remainder of his group's operations. Into 1982, Chen-chou called upon Chen-nan to help out with funding from the Cathay Investment and Trust Company. Thereafter, in a vicious circle of refinancing and expansion, Chen-chou and Chen-nan simply ignored all the legal restrictions on non-bank business operations. Through their respective financial institutions, they solicited short-term deposits, provided checking account services, offered loans far in excess of the legal ceilings, and traded debt. 10th Credit and Cathay Trust were being run as private banks – although entirely for the benefit of the two Tsai brothers and in conjunction with the normal (and therefore riskier) non-bank activities of these two institutions. When the government finally audited the books of 10th Credit in early 1985 the enterprise had virtually no reserves to speak of; the lending limit for credit cooperatives of 78% of assets had apparently been *disregarded for almost two years*. Further, more than 50% of Cathay Trust loans (a total of NT$38 billion or US$0.95 billion at the start of 1985) had been channeled to Cathay group companies.[67]

The behavior of the Tsai brothers increasingly compromised the KMT regime's finance goals of stability and control, and by 1982 the stage was set for the emergence of a policy window for bank reform. In the short-term, however, the official response was slow and tentative. Some of this can probably be explained in terms of Chen-chou's high-profile entry into the Legislative Yuan in 1983.[68] However, much of this official procrastination was the outcome of an unfortunate combination of (1) inadequate legal provisions, and (2) an over-estimation of the capacity to contain the wayward activities of Taiwan's non-banks. Senior figures in Cabinet (including Finance Minister Hsu Li-teh who we met in chapter 3) were aware as early as 1981 that Cathay executives were engaging in suspect financial dealings. But in the absence of a law specifically relevant to the trust business, a fluid definition of 'deposits' in the National Bank Law, weak penalties for fraud and financial impropriety, and ambiguous regulations regarding the appropriate role of Taiwan's oversight agencies, the monetary authorities were severely restricted in what they could actually do.[69] Various citations and fines

[67] *Taiwan Country Report, No. 2, 1985* (London: Economist Intelligence Unit, 1985), p. 5-6; *Taiwan Country Report, No. 3, 1985* (London: Economist Intelligence Unit, 1985), p. 5; and *Far Eastern Economic Review* (7 March 1985), p. 50-51.

[68] Which is the standard explanation – typically relayed with detail of Chen-chou's mischievous political dealings with a group of lawmakers called the '13 Brothers.' See esp.: Fields, *Enterprise and the State in Korea and Taiwan*, fn. 58, p. 176-178. This interpretation is too weak to stand on its own, however, as the KMT senior leadership would never have tolerated such preferential treatment for one of its own. The sacking of Wang Sheng in the fall of 1983 was testament to the reality that no one individual or faction was above the party. See: Hung-mao Tien, *The Great Transition: Political and Social Change in the Republic of China* (Stanford: Hoover Institution Press, 1989), p. 80-81.

[69] The legal deficit cannot be overstated. Five months after the government had moved to bail out 10th Credit, regulators were still debating the legality of placing limitations on Tsai Chen-chou's proprietorship rights over Cathay Plastics. Even after the full account of his reckless behavior had become clear, RoC law was silent on whether or not Chen-chou could continue to direct his company!

issued against 10th Credit between 1981 and 1984 had almost no impact on the activities of the Tsai family. Only when the Ministry of Finance had grounds for suspecting that 10th Credit was on the verge of collapse was a thoroughgoing audit considered unequivocally justifiable. And of course, when the audit was finally completed in January 1985, a depositor run ensued soon after; by this stage anything the government did was bound to elicit panic. To their credit, when substantive action was finally taken on 9 February, the Central Bank and Ministry of Finance moved swiftly and decisively. A score of Cathay business enterprises, including 10th Credit and Cathay Trust, were taken over and reorganized in a systematic and largely transparent fashion.[70]

The flipside of this legal failure was a certain gung-ho attitude regarding the government's capacity to rein-in Taiwan's non-banks. There was some justification for this confidence. In 1982, the Central Bank and Finance Ministry had handled a serious run on the Asia Trust and Investment Company with apparent ease. Although the circumstances of that crisis were not entirely similar to the events of 1985 – in the earlier case, Asia Trust found itself overexposed in the face of a downturn in real-estate prices – once again the monetary authorities only moved in when the institution concerned was on the brink of insolvency. Acting initially to provide liquidity and soon after to facilitate an institutional takeover, a major financial crisis was averted. With the bailout ultimately costing the Central Bank NT$2.2 billion (US$55 million) – a figure in the same league as that which was spent on 10th Credit three years later – within six months the event was a distant memory. By early 1985, the government had some reason to believe it could replicate the Asia Trust solution with 10th Credit.[71]

But as we have seen, the effects of the 10th Credit Cooperative scandal were far more extensive and debilitating than any previous financial predicament. In May 1985, with the dire results of the non-bank crisis increasingly apparent (including an unprecedented spike in unemployment, which reached a record high of 4.5% by August), the KMT regime commenced a search for solutions – in other words, a window of opportunity for policy reform had finally opened. An important part of this search was the establishment of the so-called Economic Reform Committee (ERC – *Jinggaihui*). The ERC was staffed by senior government officials, leading business figures and economists – including government convener Chao Yau-tung, entrepreneur Koo Chen-fu, and head of the Chung-hua Institute of Economics T. S. Tsiang – and given a broad mandate to comment on Taiwan's financial and economic policy. A major focus was the regulation of financial institutions in Taiwan, as well as a number of related areas including fiscal policy, corporate law, and trade and industry policy. Although it is true, as Noble says, that a key underlying function of the ERC was diversionary – 'to take public

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See: *Zhongyang Shibao* [Central Daily News] (20 July 1985), p. 3; and *Zhongyang Shibao* [Central Daily News] (21 July 1985), p. 3.

70 Xin-rong Xue, *Bianju Zhong de Yuejin: Yu Guo-hua de Zhengyuan Wunian* [In the Midst of Critical Change: The Five Year Cabinet of Yu Kuo-hwa] (Taipei: Zhengzhong Shuju, 1996), p. 140-142.

71 Jun Wang, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [Finance Master: Yu Kuo-hwa's Life and Travels] (Taipei: Sunbright Publishing Company, 1999), p. 363-366.

attention away from the Cathay scandal'[72] – the ERC pursued its nominal assignment with gusto. Many policy options were placed in the public sphere for the first time. ERC deliberations were front-page news for much of the remainder of 1985. The talks were completed in December with the delivery of a comprehensive report. Among the more radical of the recommendations produced by the ERC were proposals to privatize the state-owned banks, liberalize the capital account, fully rewrite RoC company and banking law and reduce trade tariffs to less than 10% across the board. The ERC was a milestone for public economic debate in Taiwan; a model of policy deliberation and consensus-building that RoC governments would use again in the 1990s and beyond.[73]

Reform of Taiwan's banking system first became a possibility in early 1985 as the KMT regime commenced a search for solutions to the 10th Credit Cooperative scandal; a sectoral-strategy window of opportunity had opened within the ruling party. In the following section of the chapter we will examine just how the young reformers used this political opening to launch their agenda for bank liberalization. For now, we turn our attention to the second KMT policy window. It is apparent from section one of this chapter that the bank reform process moved into the final stages of liberalization over the course of 1989-92. This timing would suggest that a socio-political window of opportunity must have opened within the KMT regime just prior to this. That is, sometime in 1989 or perhaps earlier the ruling party must have responded to a change in, or threat to, its social support base. Do we have evidence of this second aperture emerging within the ruling party? The remainder of this section seeks to address this question.

In chapter 4 we saw how in the post-War era, Taiwan's political economy came to be dominated by small to medium sized enterprises. By the mid 1980s, SMEs constituted around 98% of all firms in the RoC – an industrial structure that dovetailed well with the ruling party's ideological and historical distain for the concentration of capital. But despite the broad contours of economic development on the island, and much to the disappointment of the KMT regime, some concentration of private industry did occur. Over the 1960s and 1970s, large corporate identities emerged on the island, although in a manner and form which seems to have been uniquely Taiwanese.[74] Into the early 1980s, a significant number of academics and business journalists began to describe Taiwan's economic landscape at least partially in terms of large, amorphous corporate groups known as the *guanxi qiye*. The term *guanxi qiye* has never been legally defined in Taiwan, and as it came into common parlance in the 1980s generated

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[72] Gregory W. Noble, *Collective Action in East Asia: How Ruling Parties Shape Industry Policy* (Ithaca: Cornell University Press, 1998), p. 88.

[73] For details on the launch of the Economic Reform Council in May, see various articles in *Tianxia Zazhi* [Commonwealth Magazine] (1 June 1985). For the conclusion of the Council deliberations, see various articles in *Tianxia Zazhi* [Commonwealth Magazine] (1 December 1985), esp. p. 155-156. For an example of the breadth of topics considered by the Council, see also: *Gaixin, Gaixin: Wang Yong-qing dui Jingji Gaixin Weiyuanhui zhi Jianyan* [New Reforms, New Heart: Wang Yung-ching's thoughts and suggestions for the Economic Reform Council] (Taipei: written and published by the Economic Daily News, 1985).

[74] I am grateful to Dr Zhu Tian-biao for this point. Mainland China and overseas Chinese communities do not have corporate entities along the lines discussed below.

considerable debate.[75] In the battle over definition, however, one operational definition gradually gained far more acceptance than others – probably more by default than design. From the early 1970s, the business research group 'China Credit Information Service' (CCIS – *Zhonghua Zhengxinsuo*) proposed a narrow specification of three or more firms with the following characteristics: (1) total assets and sales greater than NT$1 billion for the group, (2) retention of a leading individual, management team, or pilot firm which wields the power of 'final say' over other companies in the group, and (3) universal acknowledgement of group membership.[76] CCIS further specified three basic types of intra-group organization – the sister type, the mother-child type and the marriage type (see Diagram 5.1) – each based on a variety of underlying *guanxi* links.[77]

Despite the conceptual challenges involved, the specification of the *guanxi qiye* allows us to point to a selection of relatively large, cohesive and influential business conglomerates in Taiwan prior to the apex of bank reform (see Table 5.3). Their dimensions were quite impressive, certainly in Taiwan's context but also more broadly. As of 1988, sales earnings of the top 100 *guanxi qiye* accounted for around 34% of GNP, while the top ten groups had combined annual revenues of more than NT$437 billion or 13% of GNP. The top ten groups also accounted for nearly 40% of earnings in their respective sectors. Further, nearly half of Taiwan's top ten *guanxi qiye* would have made *Fortune* magazine's 'Global 500' in the late 1980s.[78] In addition to being large in aggregate terms, the *guanxi qiye* were also spatially vast; individual *guanxi qiye* were represented in an extraordinarily range of industrial sectors. While a number of business groups, such as Formosa Plastics and Shinkong, exhibited a high degree of vertical integration, expansion into disparate markets was the norm for most *guanxi qiye*. Hamilton et.al. comment that in the mid 1980s, the top 100 *guanxi qiye* had interests in an average of four unassociated industries.[79] The final thing to be noted about the *guanxi qiye* was their relative stability over time. The growth of Taiwan's related businesses tended to match the growth of the overall economy, and did not see the kind of aggressive expansion of corporate

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[75] See: Zong-shao Chu, '*Wo Guo Guanxi Qiye zhi Xiankuang Fenxi Jiqi Yingyun Zongxian zhi Yanjiu*' [A Study of the Contemporary Circumstances and Operational Synergy of Related Enterprises in the RoC] in *Qiye Yinhang Jikan* [Enterprise Bank Quarterly] Vol. 6, No. 1 (Autumn 1982); and Hahn-koo Lee, Ichiro Numazaki and Yoshiaki Ueda, 'Comments on "Enterprise Groups in East Asia" by Hamilton, Orru and Biggart' in *Shoken Keizai* No. 162 (December 1987), p. 10-29.

[76] *Taiwan Diqu Jituan Qiye Yanjiu, Minguo 77-78 Nian* [Business Groups in Taiwan] (Taipei: China Credit Information Service, 1989), p. 29-30.

[77] In descending order of importance, the key links typically included: nuclear family, blood relatives, relatives by marriage and people sharing a common hometown (*tongxiang* – a connection with particular importance for Chinese people). Ichiro Numazaki, 'Networks of Taiwanese Big Business' in *Modern China* Vol. 12, No. 4 (October 1986), p. 494- 506.

[78] Fields, *Enterprise and the State in Korea and Taiwan*, fn. 58, p. 64-65; and *Taiwan Diqu Jituan Qiye Yanjiu, Minguo 77-78 Nian* [Business Groups in Taiwan], fn. 76, p. 1-20. Calculations performed by the author.

[79] Gary G. Hamilton, Marco Orru and Nicole Woolsey Biggart, 'Enterprise Groups in East Asia: An Organizational Analysis' in *Shoken Keizai* No. 161 (September 1987).

holdings witnessed in Japan and Korea in the 1970s and 1980s.[80] Further, a review of the top ten ranking *guanxi qiye* (measured in assets) at regular intervals between 1972 and 1988 reveals that at least half of the leading business groups in the top ten at the start of the 1970s were still there in the late 1980s. The number one position remained in the hands of Wang Yung-ching's Formosa Plastics for the entire period.[81]

Although it is tempting to see the information given above as evidence that the *guanxi qiye* were a source of increasing business pressure on economic policy in Taiwan, this view is only partially correct at best. We saw briefly in chapter 1 that through the late 1980s, the power of Taiwanese 'big business' remained strongly qualified on two counts. On the one hand, as independent entities the *guanxi qiye* were still small compared to RoC state-owned enterprises, and miniscule compared to the giant Japanese *keiretsu* and Korean *chaebol*. On the other hand, Taiwan's partially open political system offered the *guanxi qiye* few direct avenues of access to the administrative centers of policymaking.[82] But these qualifications understate the extent to which the KMT regime was prepared to go to keep business interests on the margins of its social support base. As the *guanxi qiye* could not be simply ignored – clearly, they were large enough to be an important structural constraint by the late 1980s – the ruling party engaged in some interesting social politics to keep tabs on individual corporate representatives. One aspect of this manipulation was the practice of playing favorites. The story of Koo Chen-fu is probably the most prominent example of this. Koo became head of Taiwan Cement (number 14 on Table 5.3) in the mid 1950s and the China Trust group (number four on Table 5.3) during the 1970s. As his corporate empire and intra-business contacts expanded, the KMT regime co-opted Koo – along with one or two others, including Lin Ting-sheng from the Tatung group – to establish a personal link between the ruling party and the elite of Taiwanese business. Koo's cooperative demeanor won him a seat on the Central Standing Committee of the KMT and a series of semi-formal appointments as a business and national emissary. In the early 1990s, he was made chairman of the Straits Exchange Foundation, the KMT regime's prestigious 'non-governmental organization' for handling relations with Beijing.[83]

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[80] Gary G. Hamilton and Nicole Woolsey Biggart, 'Market, Culture and Authority: A Comparative Analysis of Management and Organization in the Far East' in *American Journal of Sociology* Vol. 94, Supplement (1988), p. 61. See also: Fields, *Enterprise and the State in Korea and Taiwan*, fn. 58, p. 71.

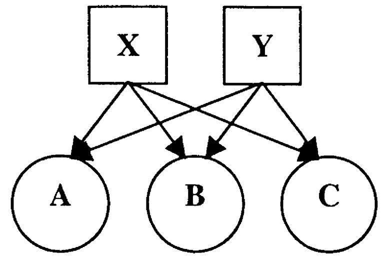
[81] Fields, *Enterprise and the State in Korea and Taiwan*, fn. 58, p. 70; and *Taiwan Diqu Jituan Qiye Yanjiu, Minguo 62-63 Nian* [Business Groups in Taiwan] (Taipei: China Credit Information Service, 1974).

[82] From chapter 1, section two.

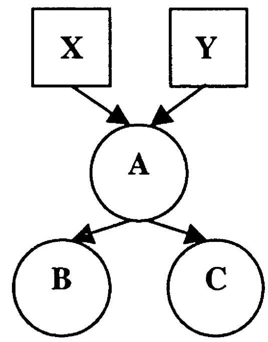
[83] While Koo made it to the top of the party-business nexus, others demonstrably did not. Despite the size and status of his Formosa Plastics, Wang Yung-ching was only ever invited to play a minor role in the ruling party's game of business representation. See esp.: Ichiro Numazaki, 'The Role of Personal Networks in the Making of Taiwan's Guanxiqiye' in Gary Hamilton (ed.), *Business Networks and Economic Development in East and South East Asia* (Hong Kong: University of Hong Kong, 1991); and Taniura Takao, 'Management in Taiwan: The Case of the Formosa Plastics Group' in *East Asian Cultural Studies* Vol. 28, Nos. 1-4 (March 1989). See also: Noble, *Collective Action in East Asia: How Ruling Parties Shape Industry Policy*, fn. 72, p. 45; and *Far Eastern Economic Review* (1 February 1990), p. 40-41.

DIAGRAM 5.1 Types of *guanxi qiye* intra-group organization

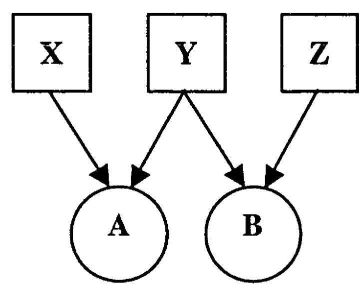
#1 Sister Type Organization:
Partners X and Y jointly establish or invest in companies A, B, and C, and the three firms are said to be in a sibling relationship. The Sampo Group was a typical example of this kind of group organization.



#2 Mother-Child Type Organization:
Partners X and Y jointly invest in company A, which subsequently invests in firms B and C. Company A then stands as parent to B and C. Tatung Group maintained features of this intra-group structure.



#3 Marriage Type Organization:
Partners X and Y invest in A, while Y and Z invest in another firm B. X and Z are therefore 'married' through their shared association with Y. For a time, this style of organization was typical of the Cathay Group.



Notes: Generally speaking, the *guanxi qiye* tend toward one of these three models, but they are not mutually exclusive.
Sources: Ichiro Numazaki, 'Networks of Taiwanese Big Business' in *Modern China* Vol. 12, No. 4 (October 1986), p. 496-501; and *Taiwan Diqu Jituan Qiye Yanjiu, Minguo 77-78 Nian* [Business Groups in Taiwan] (Taipei: China Credit Information Service 1989), p. 29-30.

For many years, Koo was also chairman of the Chinese National Association of Industry and Commerce, one of three peak representative organizations for business in Taiwan (including the Chinese National Federation of Industry and the RoC Chamber of Commerce). This leads us to the second aspect of the KMT regime's social manipulation of the *guanxi qiye*: the top-down use of industry associations (*gongye xiehui*). We saw briefly in chapter 2 how the KMT created front organizations to ensure maximum control over all established and emergent social groups on the island. Once established, these civic associations were usually assured obedience to the ruling party through penetration with party cells.[84] The number of industry associations ran into the hundreds and had a remarkable degree of sectoral coverage. Some undoubtedly had a developmental rationale attached to their establishment – e.g. the Taiwan Importers and Exporters Association. Others, like the Taipei Canned-Cake Food Manufacturers

[84] From chapter 2, section two.

Association, appear to be the outcome of little more than a political desire to be organizationally encompassing.[85] As Noble argues, the purpose of the industry associations was often only thinly disguised, formally, they came under the jurisdiction of the Ministry of the Interior (a control agency) and were typically staffed by military, party or security personnel. Leadership positions were usually derived by ruling party appointment. Association ballots were rare, and where they did occur, were often designed to simply confirm *ex post facto* a decision imposed from above.[86]

TABLE 5.3 Top twenty *guanxi qiye* in 1988-89 by group assets (NT$1,000,000s)

Rank	Group	Assets	Rank	Group	Assets
11	Formosa Plastics	131,720	11	Pacific Electronics*	19,246
2	Lin Yuan	96,310	12	China Rebar	17,471
3	Shin Kong	62,695	13	Tunex	17,104
4	China Trust	61,695	14	Taiwan Cement	13,761
5	Far Eastern	45,260	15	Qingfeng Investment*	12,036
6	Tatung	39,266	16	Wei Chuan	11,570
7	Tainan Textiles	37,651	17	Sampo	11,308
8	Yulon Motor	31,721	18	Yuen Foong Yu	10,967
9	Zhongxing Textiles*	25,562	19	Internatnl. Telephone*	10,809
10	Yixin*	25,534	20	China General	10,774

Notes: Group titles specified with an asterisk are directly translated or romanized from the Chinese and may not correspond with the official English names of these business groups.
Sources: *Taiwan Diqu Jituan Qiye Yanjiu, Minguo 77-78 Nian* [Business Groups in Taiwan] (Taipei: China Credit Information Service, 1989), p. 2.

The KMT's politicking left the *guanxi qiye* with little room to maneuver, and for many years business was effectively locked-out of the regime's support base. There were early signs, however, that this comfortable arrangement could not continue indefinitely – a socio-political window of opportunity for bank reform was about to open. Change was not a direct function of the increasing size and prominence of the *guanxi qiye per se*,[87] but part of the broader evolution

[85] See esp.: *Taiwan Zhinan* [Directory of Taiwan] (Taipei: The China News, 1989), p. 132-165.
[86] Noble, *Collective Action in East Asia: How Ruling Parties Shape Industry Policy*, fn. 72, p. 44-45. Augmented with interviews in Taipei, 1999.
[87] Which is the reason I have not presented the 10th Credit Cooperative scandal and the machinations of the Tsai family as part of the present story on the *guanxi qiye*. Analytically, the topics are quite distinct: one is a narrow story about the behavior and manipulation of certain types of financial institution, the other a broad account of business advocacy within a context of increasing political pluralism. Insofar as the aim of any social-science analysis is to relate a generalizable account, focusing on the common ground between the two stories presented herein – i.e. the fact that 10th Credit scandal just happened to occur within the Cathay *guanxi qiye* – is not necessarily significant and may indeed be misleading. To my mind, this is a key problem with Karl Field's work. See: Fields, *Enterprise and the State in Korea and Taiwan*, fn. 58, esp. chp. 5. Fields' account of the 10th Credit scandal is a one-off story about intra-*guanxi qiye* intrigue. The simpler and more widely applicable story about the problems associated with

of political pluralism in Taiwan. We saw in chapter 3 that the early interplay between the ruling party and opposition *dangwai* simultaneously produced demands for middle class inclusion and opportunities for regime cooptation – the end result in the area of finance policy being Taiwan's first steps toward securities liberalization.[88] Through the mid to late 1980s, the dynamic between the KMT and opposition deepened and diversified. After the establishment of the Association for Public Policy Research in 1983 (the first move toward an opposition political party) *dangwai* activists stepped-up their efforts on two fronts: applying pressure to the ruling party for democratic concessions, and intra-opposition organization. With a series of increasingly rowdy street demonstrations and a campaign of procedural disruption in the Legislative Yuan, the *dangwai* strived to engage the KMT in political negotiation. Although initially these efforts were unsuccessful – and even counterproductive from a public relations perspective – in early 1986 the ruling party opened up talks with opposition moderates. This culminated in September with a surprise announcement by President Chiang Ching-kuo that martial law would be lifted (brought to fruition in July 1987), and an equally surprising move by the opposition to openly establish the Democratic Progressive Party (just in time for the December 1986 elections).[89]

As the opposition movement gained in strength through 1987-88 – buoyed by an increase in the DPP's legislative presence – the KMT commenced a period of protracted leadership transition and adjustment. On the occasion of CCK's death in January 1988, Lee Teng-hui rose to power, in the first instance as alternate RoC President and KMT Chairman. The early months of 1988 saw Lee successfully secure his right to office as CCK's appointee, although in the face of stubborn internal opposition from a core of KMT conservatives. Toward the middle of the year, the acting President commenced the task of acquiring office in his own right. Lee outmaneuvered the conservatives at the KMT's 13th National Congress in July to win the ballot for party chairman. In the ensuing appointment process for the Central Committee and Central Standing Committee, Lee's preferred candidates also prevailed and the influence of party conservatives was seriously compromised. Lee then turned his attention to the RoC Presidency. The much-awaited passage of the Civic Organization Law in early 1989 (finally legalizing the creation of opposition political parties) and a poor showing by the KMT at the Legislative Yuan elections in December lent weight to Lee's cause. Touting himself as a leading light of democratization and internal KMT reform, in April 1990 Lee Teng-hui was officially elected President at the spring session of the RoC National Assembly. This act solidified Lee's position

regulating non-banks is completely lost. Further, the broad phenomenon of increasing business power in Taiwan is reduced to an episodic and enterprise-specific account.

[88] From chapter 3, section three.

[89] Kuang-yu Ji, *Zhonghua Minguo de Zhengzhi Fazhan: Minguo 38 Nian Lai de Bianqian* [Political Development of RoC] (Taipei: Yangzhi Wenhua Chubanshe, 1996), p. 508-501; and Yun-han Chu, *Crafting Democracy in Taiwan* (Taipei: Institute for National Policy Research, 1992), p. 42.

in the KMT regime and muted the strength of intra-party opponents – a situation that became a key feature of Taiwan politics through the remainder of the 1990s.[90]

The fluid political environment detailed above gradually and inadvertently provided the *guanxi qiye* with an unprecedented chance to voice their opinion on economic policy. From the conclusion of the KMT's 13th National Congress in July 1988, business advocacy became a regular feature of the island's policy discourse. Although mostly negative and reactive, industry demands were typically channeled through compliant lawmakers in the Legislative Yuan, based on surreptitious and often quasi-corrupt relationships referred to as 'political-business networks' (*zhengshang guanxi* or *zhengshang wanglu*). Much of the dynamic of business advocacy was actually internal to the KMT regime itself: the Executive Yuan would present a proposal to the Legislative Yuan for a change in economic policy, whereupon KMT legislators with business links would do their utmost to see it destroyed or turned into a source of corporate rent. Success in such endeavors was actually quite rare, but the process always made for spectacular politics. The proposal to introduce a 0.3% tax on securities transactions in September 1988, for example, caused an uproar in the Legislative Yuan and allegedly inspired several stock manipulation schemes by politician-business insiders. The Taiwan Stock Exchange nosedived into a mini-crash in late September. Eventually, Cabinet returned with a 0.15% tax that was passed in October and finally introduced in January 1989.[91]

As business acquired a public voice – albeit only partial – the KMT regime commenced a search for further means to silence and subjugate it. In the new political environment, keeping the *guanxi qiye* on the extremities of the ruling party's social support base required more restraint than in the past – more emphasis on the carrot than the stick. In this context, from around mid 1988 the ruling party began to look seriously at Taiwan's banking industry as a source of political diversion. There were several aspects to this new approach, two of which are worthy of mention here. First, with due attention to such issues as industry entry, bank liberalization was an attractive instrument to intensify inter-*guanxi qiye* rivalry. The capacity to play off the *guanxi qiye* had already been proven effective with the introduction of the new securities companies. After May 1988, it will be recalled from chapter 3, the Securities Exchange Commission started accepting applications for new securities firms. Partially in a bid to see that no one dominated the new private business in brokerage, dealing and underwriting, the SEC issued an inordinate number of licenses – some 100 by the end of 1988 and more than 370 by the end of 1989. In and of itself, this move made little sense economically but it

[90] Steven J. Hood, *The Kuomintang and Democratization of Taiwan* (Boulder: Westview Press, 1997), chp. 6, esp. 93-101; and James D. Seymour, 'Taiwan in 1988: No More Bandits' in *Asian Survey* Vol. 29, No. 1 (January 1989), esp. p. 56-58.

[91] See esp.: *Tianxia Zazhi* [Commonwealth Magazine] (1 November 1988), p. 54-76. Includes a feature article on Legislative Yuan links to business. See also: Chen, 'Taiwan Yinhang Zhengce de Zhengzhi Jingji Fenxi' [The Political Economy of Taiwan's Banking Policy], fn. 8, chp. 4; and *Taiwan Country Report, No. 4, 1988* (London: Economist Intelligence Unit, 1988), p. 12-13.

certainly kept major corporate players on the Taiwan Stock Exchange in check.[92] If new bank licenses were issued with similar fervor, the KMT regime could replace attentive subjugation with competition in its treatment of the *guanxi qiye*. Needless to say, as with the securities case, questions of bank economies of scale and sectoral capacity were rendered irrelevant by such calculations.

Second, bank opening was an effective means for the KMT regime to increase scrutiny of the *guanxi qiye*'s internal financial activities, while retaining formal detachment. Opaque financial management had long been a feature of business administration on Taiwan, and regularly became an item of public debate when leading corporate groups experienced repayment difficulties or went bankrupt (the 10th Credit Cooperative scandal generated discussion along these lines). Most corporations had two sets of financial statements: those intended for company insiders and those meant for government oversight agencies or creditors.[93] By and large, this situation was tolerated. Among other things, it gave the KMT regime a legitimate excuse to keep the affairs of business at arm's length. But it was also a lost opportunity. Systematic scrutiny of corporate finances could have been used to exercise ruling party control over wayward *guanxi qiye*. The challenge was to introduce administrative arrangements that retained the desired distance, but left the extent of regime reach beyond doubt. Bank opening was one such option. The establishment of new private banks, the adoption of more market oriented lending policies by state owned institutions, and so on gave the ruling party a practical reason to increase financial oversight activities. However, this surveillance would be mediated and limited: the financial authorities would only delve as far as necessary to ascertain if, for example, bank loans were being misappropriated within a corporate group. Larger questions of financial management – e.g. tax avoidance – could remain safely at a distance from the ruling party.[94]

These socio-political incentives reinforced the KMT's sector-specific imperative to reform Taiwan's banking industry. Thus, through mid to late 1988, the second window of opportunity for the young reformers opened. After a leisurely three to four years, reform of Taiwan's banking system had become an entirely expeditious political end; comprehensive policy change was now a strong prospect.

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[92] By the second half of 1988 it was apparent that the fledgling securities industry was overheating: around 6,000 jobs had been generated by the establishment of the new securities firms, and with precious few skilled personnel to fill them, wages blew-out to unsustainable levels. Further, by the end of 1988, the high number of new securities firm licenses was seen as an adjunct to the TSE bubble and there were calls for a slowdown in issuance. *Taiwan Country Report, No. 4, 1988* (London: Economist Intelligence Unit, 1988), p. 24-25. See also: *Gongshang Shibao* [Commercial Times] (3 May 1988), p. 17; *Gongshang Shibao* [Commercial Times] (6 May 1988), p. 16; and *Tianxi Zazhi* [Commonwealth Magazine] (1 August 1988), p. 90-95.

[93] Issues covered in: Jane Kaufmin-Winn, 'Reform of the RoC's Corporate Reorganization Law Needed' in *Financial and Investment Yearbook, RoC 1987* (Taipei: Central Economic News Service, 1987), p. 28-32.

[94] Interviews in Taipei, 1996 and 1999.

4. Managing the middle way

A strong prospect perhaps, but by no means a certainty. In the discussion above we have seen how in 1985 and then again in 1988, bank reform emerged as a prudent political tactic for the ruling KMT. The association between the ruling party's two policy windows and the actual process of bank reform is relatively clear: bank opening starts in early 1985 as the sectoral-strategy window opens, and then reaches a high point (and eventually concludes) after the appearance of the socio-political window in the latter half of 1988. The opening of these policy windows within the KMT regime was a necessary prerequisite for bank reform, but reform did not automatically take place. For that, sustained effort by the young reformers was needed. I would argue that the likes of Shirley Kuo and Wang Chien-shien used the two KMT windows of opportunity to introduce and consolidate their agenda for bank liberalization. What is the basis for this claim?

In accord with the previous case studies of this thesis, it is important to consider three items of evidence. First, a close look at the historical record shows that after early 1985 and late 1988, the young reformers became more active in the pursuit of bank policy change. Much of the earlier activity is difficult to observe, as the young reformers were not the predominant faction within Cabinet in the wake of the 10th Credit Cooperative scandal. Beneath the unadventurous policy response of Yu Kuo-hwa's finance technocrats,[95] however, the young reformers were busy making their case for institutional transformation. The most obvious example of this adjustment in behavior was Wang Chien-shien's public relations campaign for financial reform over 1985. From January, the Vice-Minister of Economic Affairs conducted a sustained but careful critique of prevalent financial policy, arguing that Taiwan's real economy had fundamentally changed since the 1950s and the financial system needed to keep up with this development. He pointed to bank reform in Korea and elsewhere as evidence that the island's policy framework was increasingly out of step with the times.[96] Beyond broad publicity work, the Economic Reform Committee also provided a unique venue for a number of the young reformers to have substantive input into the emerging bank policy agenda. Both Wang Chien-shien and Shirley Kuo were junior participants in the ERC – Wang as sub-convener for the ERC's tax panel and Kuo as an advisor to the finance panel.[97] It must be remembered that the ERC's final collection of recommendations – very much a liberal document – was by no means a foregone conclusion. Indeed, press commentary at the time suggests that ERC deliberations

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[95] See chapter 4, section two; and note comments on Yu's response to the 10th Credit Cooperative scandal in: Xue, *Bianju Zhong de Yuejin: Yu Guo-hua de Zhengyuan Wunian* [In the Midst of Critical Change: The Five Year Cabinet of Yu Kuo-hwa], fn. 70, p. 140-142.

[96] Wang contributed opinion editorial pieces or conducted interviews with *Jingji Ribao*, *Tianxia* and several other business magazines and newspapers. See for example: *Tianxia Zazhi* [Commonwealth Magazine] (1 January 1985); *Tianxia Zazhi* [Commonwealth Magazine] (1 February 1985); and *Tianxia Zazhi* [Commonwealth Magazine] (1 June 1985).

[97] Wang, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [Finance Master: Yu Kuo-hwa's Life and Travels], fn. 71, p. 430-431; and interviews in Taipei, 1999.

encompassed considerable 'internal education.'[98] This fluid environment must have favored those with reasoned and coherent programs for bank policy change – i.e. the young reformers.

Further, it is clear that as *guanxi qiye* advocacy reached new heights into late 1988, so too did the reform activities of our younger technocrats. Through the second half of 1988, several young reformers were elevated to senior positions within Cabinet and, riding a wave of public enthusiasm for change, immediately commenced a campaign of economic policy renewal. As new Finance Minister, Shirley Kuo's sudden zeal for bank opening surprised many observers. The press portrayed the hitherto reserved Kuo as an intriguing paradox: 'shuo xiao, zuo da' [to say very little, but do a lot] seemed the only appropriate way to describe the first woman to be admitted to the Executive Yuan and the Central Standing Committee of the KMT.[99] As she warmed to her new post, Kuo went public for the first time with her plans for bank reform. Using a mix of academic and plain language intended for a broad audience, she spoke of the need for interest rate liberalization, change in bank management practices, privatization and (most significantly for business) new entry into the banking market.[100] Behind the scenes, she was energetically preparing the regulatory basis for change. In an interview with the author, Kuo describes this time as not only frantic, but almost fun: 'I proceeded rapidly and with determination, taking this [redundant regulation] away and that away....The time was ripe for change, and so we did what we had to do!' And this effort paid dividends: within 12 months of taking office, Kuo presided over the introduction of the RoC's new banking law, an event she describes proprietarily as a major highlight of her career.[101] After his appointment to Cabinet in early 1990, much of Wang Chien-shien's time was devoted to promoting new bank entry. In the middle of the year he launched the Standards for the Establishment of Commercial Banks and commenced the task of assessing applicants. It is apparent from interviews that the final decision on new licenses – proclaimed in early 1991 – also ultimately resided with Wang.[102]

Second, there is some evidence that the young reformers were conscious of the KMT windows of opportunity that opened in 1985 and 1988. In interviews with the author, for example, both Wang and Kuo acknowledged that the 10th Credit scandal had an impact on the general enthusiasm for reform. In Wang's own words '...it certainly generated a lot of discussion and focused the reform effort.'[103] Beyond this basic acknowledgement, however,

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[98] See esp.: *Tianxia Zazhi* [Commonwealth Magazine] (1 June 1985), p. 98; and *Tianxia Zazhi* [Commonwealth Magazine] (1 December 1985), p. 152-154.

[99] *Tianxia Zazhi* [Commonwealth Magazine] (1 August 1988), p. 154-164. Includes special introduction article on Kuo.

[100] *Tianxia Zazhi* [Commonwealth Magazine] (1 October 1988), p. 48-57. Part of Cabinet review article including material on Kuo, Chen Fu-an and Qian Fu.

[101] Interview in Taipei with Professor Shirley Kuo, Minister Without Portfolio, RoC Cabinet, 4 December 1996.

[102] Various interviews in Taipei, 1996 and 1999; including interview with Mr Wang Chien-shien, Chairman, the Renewal Foundation, 9 July 1999.

[103] Interview in Taipei with Professor Shirley Kuo, Minister Without Portfolio, 4 December 1996; and interview in Taipei with Mr Wang Chien-shien, Chairman, the Renewal Foundation, 9 July 1999.

Wang and Kuo are silent on the impact of 10th Credit.[104] This reticence can probably be explained in terms of proximity to the issue: both technocrats were very close to individuals who lost their jobs over the scandal, and might naturally be reluctant to talk about it (e.g. Hsu Li-teh was Minister of Economic Affairs while Wang Chien-shien was Vice Minister). A number of immediate friends and associates of the young reformers were less inhibited, however. Professor Liang Kuo-shu, Shirley Kuo's colleague and personal friend from National Taiwan University (and one-time co-worker at the Central Bank of China), stated without reservation:

> 'The Cathay financial scandal has clearly demonstrated that the failure of financial institutions has serious repercussions extending far beyond the financial sector. With the process of market restructuring and regulatory reform incomplete, financial deregulation and fundamental reform of the financial system are urgent imperatives.'[105]

And then there were the press leaks. Over the course of 1985 junior staff of the economic ministries were a dependable source of inside information for Taiwan's print media on the 10th Credit Cooperative scandal. Invariably, these leaks were tied to a plea for reform, and most of the time were anonymous. They leave little doubt that at least some technocrats were well and truly aware that a chance for change had arrived.[106]

Further, there is evidence to confirm that the young reformers were aware of the policy window generated by the politics of *guanxi qiye* advocacy. In interviews, for example, both Shirley Kuo and Wang Chien-shien referred to increased business lobbying through and beyond 1988. Kuo notes that: 'We were hit with [a series of] demands for regulation change.' Wang recalls that: 'Representatives of the private sector spoke very loudly in favor of financial reform....When I was Finance Minister, we were lobbied very strongly by important businessmen in Taiwan anxious to get new bank licenses.'[107] Substantive actions attributable to the young reformers also reveal an awareness of the socio-political context. Shirley Kuo's decision to set the capitalization ratio for new bank applicants at the high level of NT$10 billion (c. US$400 million) and to restrict the level of investment in new banks by enterprise groups to

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[104] The 10th Credit Cooperative scandal is conspicuously absent from Kuo's academic work of the late 1980s. This is despite the fact that in a number of cases she specifically identifies 1985 as a turning point in the regulation of RoC banking. See esp.: Shirley W.Y. Kuo, 'Liberalization of the Financial Market in Taiwan in the 1980s,' keynote address at the First Annual Pacific Basin Finance Conference, Taipei, Taiwan (14 March 1989); and Christina Y. Liu and Shirley W.Y. Kuo, 'Interest Rate and Foreign Exchange Liberalization in Taiwan in the 1980s' in Seiji Naya and Akira Takayama (eds.), *Economic Development in East and Southeast Asia: Essays in Honor of Professor Shinichi Ichimura* (Singapore: Institute of Southeast Asian Studies, 1990).

[105] Kuo-shu Liang, 'Financial Reform, Trade and Foreign Exchange Liberalization in the Republic of China' in *Economic Review* [journal issued bimonthly by the International Commercial Bank of China] No. 242 (March-April 1988), p. 6.

[106] See e.g.: *Zhongguo Shibao* [China Times] (28 July 1985), p. 1-2; *Tianxia Zazhi* [Commonwealth Magazine] (1 June 1985), p. 160-170; and *Tianxia Zazhi* [Commonwealth Magazine] (1 September 1985), p. 12-21.

[107] Interview in Taipei with Professor Shirley Kuo, Minister Without Portfolio, RoC Cabinet, 4 December 1996; and interview in Taipei with Mr Wang Chien-shien, Chairman, the Renewal Foundation, 9 July 1999.

15% of total capitalization speaks directly to the cause of keeping the *guanxi qiye* in check. At the time, Kuo received considerable criticism for this initiative, which was seen as both unnecessary and a drag on the future efficiency of the new institutions – criticisms that eventually were proven largely correct. Similarly, Wang Chien-shien's decision in 1992 to issue 15 new bank licenses in the first instance (out of a pool of just 19 applicants) reveals a strong desire to prevent any kind of market concentration. As the 1990s progressed, the downside of this move was displayed in all its glory. Taiwan's banking sector became chronically over-serviced, eventually and perhaps ironically giving rise to the prospect of institutional mergers.[108]

Finally, consider the counterfactual alternatives to young reformer leadership on bank liberalization. What if someone else within the KMT regime was promoting the cause of bank opening? This alternative is certainly a strong possibility. We know that at least in the early days of bank liberalization, Kuo, Wang and other young reformers were still relatively new players among the KMT policy elite. Further, we also know that intra-party pressure to *do something* in the wake the 10th Credit Cooperative scandal was strong: witness CCK's angry proclamation on 4 February 1985 that the ruling party must 'fight against monopoly, fight against special privilege, and fight against profiteering.'[109] But identifying a group or individual within the KMT regime that was committed to bank opening – apart from the young reformers – is extremely difficult. Indeed, for most of the major players within the KMT hierarchy at this time – including the finance technocrats who we met in chapter 4 – the instinctive reaction to the worst financial crisis in Taiwan's post-War history was to crack down on the excesses of the non-banks, *not* to pursue broad institutional opening.[110] Through 1985, bank reform was really a counterintuitive response for the ruling party; and yet, as we saw in section one of this chapter, the argument for change ultimately held some sway in the decision-making process. Obviously, someone within the KMT regime was making the case for liberalization in 1985, and the most likely group of protagonists was the young reformers.

And what about 1988? We know that on at least one occasion over the course of the year, new President Lee Teng-hui publicly affirmed his support for privatization of the 'big three' state-owned banks (i.e. First Commercial, Chang Hwa and Hua Nan). But if Lee was genuinely committed to bank opening, we might have expected to see him pursue this cause with the main institutional opponent of privatization at that time – the Taiwan Provincial Assembly (as a majority stockholder in the big three). As President and KMT Chairman, Lee could have

[108] Interviews in Taipei, 1996 and 1999. See also: *Jingji Ribao* [Economic Daily News] (18 July 1989), p. 1; *Jingji Ribao* [Economic Daily News] (19 July 1989), p. 2; *Far Eastern Economic Review* (4 April 1991), p. 36-37; and *Far Eastern Economic Review* (11 July 1991), p. 35-36.
[109] In: Fields, *Enterprise and the State in Korea and Taiwan*, fn. 58, p. 179.
[110] The island's trust companies endured the brunt of this clean-up operation – a movement that only intensified after the failure of the Overseas Trust Corporation in September 1985. See esp.: *Tianxia Zazhi* [Commonwealth Magazine] (1 November 1985), p. 86-94. Includes an excellent overview of the poor state of Taiwan's trust industry in 1985, with some interesting commentary on the blunt handling of these problems by the Ministry of Finance and other oversight agencies.

chosen to force the issue, and yet he remained passive. The Taiwan Provincial Assembly ultimately voted to retain their stake in the big three banks, whereupon Lee summarily dropped the matter.[111] As briefly intimated in chapter 3, Lee's behavior in this case can more than likely be explained in terms of his efforts to secure the presidency and party chairmanship. In the early days of Lee's rule, there was good political capital to be made from a strategy of soft support for bank privatization: it would isolate KMT conservatives, rally those with reformist sentiments (including our young reformers), and loosely channel public and party scrutiny of the new Lee administration into a relatively safe area. Once the need for these things had subsided, however, a strategy of soft support could be readily and conveniently abandoned.[112] Not surprisingly, after the KMT's 13th National Congress, Lee never returned to the issue of bank privatization again.[113]

Outside the immediate boundaries of the KMT regime, there are one or two other players who may have forced bank reform onto the public agenda. In the aftermath of the 10th Credit Cooperative scandal, Taiwan's community of economists was particularly vocal. A number of high-profile academics were present at the ERC discussions (including T.S. Tsiang from the Chung-hua Institute of Economic Research) and some of these individuals made strident calls for policy change.[114] It must be remembered, however, that Taiwan's academic economists by no means presented a united front on the bank reform issue. The 10th Credit Cooperative scandal opened up serious disagreements within the group. Some of the dividing lines included: (1) *new bank licenses* – some economists were keen to new private banks enter the market while others were concerned about creating slush-funds for business; (2) *interest rate liberalization* – discussion was split between those who wanted the real cost of capital represented in the price of deposits and loans, and those who feared a negative impact on investment; and (3) *privatization* – some argued that privatization of the state-owned banks would deliver more efficiency, but others were adamant that Taiwan's stock market was insufficiently mature to handle the process of securitization.[115] Clearly, a consistent line of argument on bank policy

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111 See e.g.: *China News* (10 May 1988), p. 4; *China News* (25 May 1988), p. 11; and *China News* (27 May 1988), p. 11. See also: Yang, 'San Shangyin Minyinghua yu Xin Yinhang Kaifang Sheli Zhengce zhi Yanbian' [The Evolution of Reform Policy for Privatization of the 3 Commercial Banks and the Establishment of the New Banks], fn. 17, p.39-52.

112 Based on interviews in Taipei, 1999; esp. interview in Taipei with Mr Wang Chien-shien, Chairman, the Renewal Foundation, 9 July 1999.

113 Indeed, there were a number of occasions over the 1990s where Lee, if genuinely committed to privatization of the big three, might well have said something about it. We might have expected, for example, that the early 1997 decision to freeze the activities of the Taiwan Provincial Government would see Lee raise the issue of bank privatization as a desirable side-effect. Although almost everyone else made this link – see e.g. *Jingji Ribao* [Economic Daily News] (9 January 1997), p. 1; *China News* (11 January 1997), p. 7; and *China Post* (9 January 1997), p. 1 – Lee himself was conspicuously silent on the matter.

114 The popular perception of the 1985 debates on financial policy typically depicts such enlightened individuals pitched against a protectionist government. Interviews in Taipei, 1996; including interviews with officers from Taishin International Bank, 1 October 1996.

115 Yang, 'San Shangyin Minyinghua yu Xin Yinhang Kaifang Sheli Zhengce zhi Yanbian' [The Evolution of Reform Policy for Privatization of the 3 Commercial Banks and the Establishment of the New Banks], fn. 17, p. 33-36; and interviews in Taipei, 1999. The divisions reflected broader public

was not forthcoming from local economists. Any reform advice adopted from this group was selectively introduced to the policy agenda; and who other than the young reformers would have had an interest in this process of selection?

But what of the input of the *guanxi qiye*? What if they were the original source of bank reform, especially after mid 1988? As noted elsewhere, we know that around this time Taiwan's big business groups were structurally influential, had at least a partial mouthpiece within the Legislative Yuan, and had lobbied senior economic technocrats for some form of bank policy adjustment. But if big business was the ultimate source of change, we might expect to see at least a mild correlation between: (1) the extent to which these factors were actually extant, and (2) the benefits accrued from bank reform. In the event, the outcome of policy change was more non-discriminatory than this hypothetical correlation would imply. What is striking, for example, about the distribution of new bank licenses in 1991 is not who got them – many of Taiwan's big business groups were indeed successful[116] – but just how many licenses were actually issued. As commented above, the Ministry of Finance under Wang Chien-shien's direction gave out 15 new licenses from a total pool of just 19 applicants. The four losers in the license lottery were excluded reluctantly. The applicants for one new bank – a consortium of related business enterprises from Ilan County – were implicated in a stock trading scandal and had to be dismissed as a matter of prudence. As the 1990s rolled on, even more licenses were granted; by the end of the decade there were fully 22 new banks in Taiwan. Clearly, any bias in the selection process for private banks was not toward big capital *per se*.[117]

Conclusion

It has been the argument of this chapter that the process of bank reform in Taiwan from 1985 to 1992 was ultimately driven by the ideas and exploits of the 'young reformers' – a younger cohort of technocratic elites which included the likes of Shirley Kuo and Wang Chien-shien – and followed a pattern dictated by the 'middling' spread of opportunities presented within the ruling KMT. The young reformers' thinking on bank policy was motivated by two interrelated factors: a belief that Taiwan's banking sector was grossly inefficient and uncompetitive, and a vision that the local financial system could one day compete as a regional or global financial center. Reform moved from the conceptual stage to policy practice as party political windows of opportunity opened up in early 1985 and midway through 1988. In contrast to the cases of securities and forex reform which we reviewed in chapters 3 and 4 of the study, the temporal spread of opportunities that faced the young reformers was neither broad nor narrow, but

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debates in Taiwan at the time. See esp. the public surveys in: *Tianxia Zazhi* [Commonwealth Magazine] (1 September 1985), p. 106-108; and *Tianxia Zazhi* [Commonwealth Magazine] (1 December 1985), p. 158-160.

[116] For a simple overview in English, see: *Far Eastern Economic Review* (11 July 1991), p. 36. For a more in-depth review in Chinese, see: *Caixun* [Wealth Magazine] (1 June 1992), p. 172.

[117] Which is not to say there was no bias at all. Some analysts believe that the application rules for new banks were 'interpreted very creatively' to allow a KMT-backed consortium – the proprietors of Hua Hsin Bank – to gain a license. Discussion in Taipei with Dr Kuo Cheng-tian, 1999.

somewhere between these two extremes. Early in 1985, the policy agenda of the young reformers caught the attention of the KMT regime because it offered a means to deal with the 10th Credit Cooperative crisis, an event which radically undermined the ruling party's preference for a stable and controllable financial sector. After mid 1988, reform gradually progressed to the apex and consolidation phases because it came to be seen as a useful instrument for manipulating Taiwan's increasingly vocal strata of big business interests. The three to four years between these two windows meant that the young reformers were able to promote a considered but timely process of bank reform.

As with our earlier case-study chapters, the present chapter was composed of four main parts. In part one I surveyed the process of bank reform as it unfolded between 1985 and 1992. This section focused on the procedural and institutional effect of liberalization. In part two we looked behind the outcomes detailed in part one to analyze why it all happened. This section included an examination of the composition and ideas of the so-called young reformers – the original protagonists of the bank liberalization story. Part three of the chapter was dedicated to examining the policy windows that emerged within the KMT regime between early 1985 and mid 1988. In this extended section of the chapter we reviewed why and how these windows opened. Finally, in part four of the chapter, we briefly consider how the young reformers took advantage of the opportunities as they arose. As an adjunct to the factual data, I included counterfactual tests to butress the case for technocrat leadership. The reader will possibly note that in section three of the chapter, the order of the KMT policy windows was the opposite of the previous case studies. The policy windows for bank reform emerged in the order of (1) sector-strategy window, and then (2) socio-political window – the reverse of securities and forex reform. From the evidence reviewed, it appears that the sequence of the windows is not important to the pattern of financial reform; what matters is the temporal distribution of opportunities. This finding is consistent with our theoretical discussion earlier in the study. For technocrats with a reform agenda in mind, a run on a financial institution or an increasingly demanding business sector represents the same thing: a party political chance for change.

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-Conclusion-
Bringing agency back in and technocrat leadership beyond the late 1980s

I began this thesis with a series of questions about policy change and the role of leadership. While a definitive reply to those provocative queries is probably beyond the scope of just one study (or perhaps even several), the material we have considered herein provides some initial confirmation of the view that routine political choice is indeed tied to 'smart, dedicated, or at least unusual people.' The ideas and efforts of Taiwan's economic technocracy left an indelible mark on the island's three waves of financial reform in the late 1980s. Ignoring this group in the story of RoC securities, foreign exchange and bank liberalization would be akin to writing a history of Japanese post-War foreign policy and neglecting to mention the contribution of Prime Minister Yoshida Shigeru – you could probably do it, but it would be a hollow and ultimately misleading account. The practice of leadership matters at all levels, not just in areas commonly considered to be 'high politics.' Leaving aside the leadership phenomenon in lower-order political choice seems at best deficient, and at worst foolhardy.

The real debate concerns how to deal with leadership practices in a rigorous and systematic fashion – i.e. the methodological issue of operationalizing the concept of leadership and deriving testable hypotheses. This thesis has attempted to meet this challenge head on. The study commences with a simple puzzle regarding the historical and party-political conundrum posed by Taiwan's experience of financial reform. Reform was introduced in three consecutive waves of legal amendment, including passage of new laws for the foreign exchange system, securities and banking in 1987, 1988 and 1989 respectively.[1] These three waves of liberalization were juxtaposed against a record of strong state intervention in all areas of finance. The KMT regime controlled almost every facet of credit allocation in Taiwan, a level of intervention, or perhaps more correctly 'interference,' which was matched in most other sectors of the economy. Very few capitalist economies can claim to have had such a strong role for government in such a crucial sector of national production. And then everything changed. By the early to middle 1990s, Taiwan was fast losing its reputation as a protected market for savings and investment, and steadily acquiring a reputation for openness – perhaps not as liberal as the financial systems of Hong Kong and Singapore, but certainly in the same club as these paragons of free-market finance. Just how did the Taiwan financial system move from virtual autarky to a largely open market for credit in just over half a decade? This policy shift is rendered doubly intriguing when we consider that it occurred under the auspices of the same political regime that built the original dirigiste financial system in the first place: i.e. the KMT.

[1] Lawrence S. Liu, 'Brave New World of Financial Reform in Taiwan, the Republic of China - Three Waves of Internationalization and Liberalization and Beyond' in *Chinese Yearbook of International Law and Affairs* Vol. 8 (1988-89).

If financial liberalization involves at least some loss of authority or influence for a political regime, then why did the KMT choose to disempower itself? If, as Stephan Haggard has intimated, policy choices that weaken the political authority of governments are unlikely to be pursued,[2] why then did the KMT seek to make such a choice? We are faced with a paradoxical situation in which a regime with ambiguous credentials on economic policy embarks upon radical free-market reform. How can we explain this contradiction?

The explanation I have offered to account for this puzzle – my 'theory of technocrat leadership' – starts from the premise that leadership is a *practice* involving idea generation, creative effort, teamwork and opportunism,[3] that can be characteristic of outstanding groups as much as individuals. The thesis focuses on a small group of economic policy elites in Taiwan (the economic technocrats of the RoC state), and seeks to analyze the structural and temporal character of their relationship with the ruling KMT. The dynamic in this relationship, at least insofar as it relates to the financial reform story, centers on two KMT 'policy windows' – specifically, a socio-political window and a sectoral-strategy window.[4] At its most basic, the theory of technocrat leadership predicts two things. First, in any given episode of financial opening we should be able to distinguish the presence of a core group of technocrats with an exante or independent plan for financial reform. With the emergence of a policy window within the governing political party, we should be able to observe these technocrats 'seize the day' and attempt to implement their plan for policy change. Second, behind a full cycle of financial reform we should be able to observe the successive emergence of both party-political windows of opportunity. The temporal distribution of these two policy windows will influence the way technocrats pursue reform objectives: a wide distribution of windows will mean reform efforts are slow and incremental, while a narrow distribution will mean reform is fast and decisive.

The variable process of policy change *across* Taiwan's three main waves of financial opening (see Diagram Con.1 for a figurative representation) provides a convenient series of comparative tests for these two predictions. As we saw in chapter 3 of the thesis, the slow process of securities reform owed much to the work of the so-called 'development technocrats,'

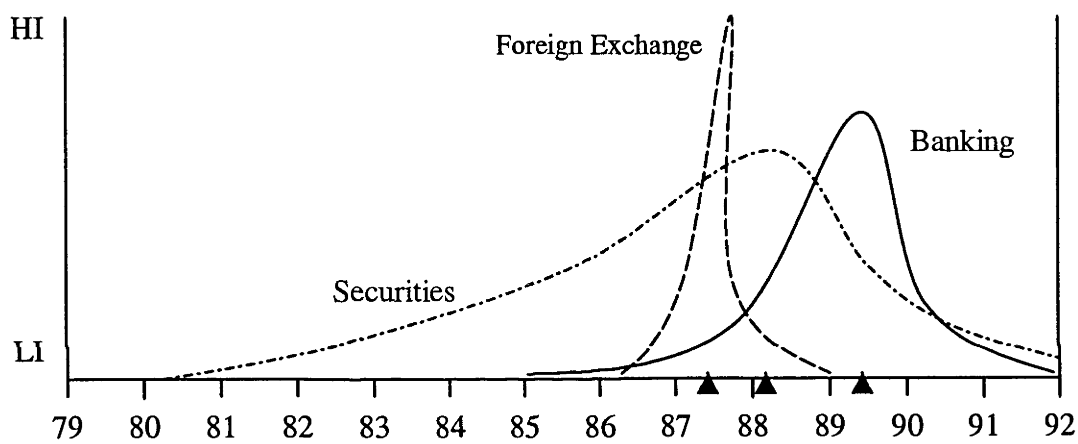
[2] Stephen Haggard, 'The Politics of Industrialization in the Republic of Korea and Taiwan' in Helen Hughes (ed.), *Achieving Industrialization in East Asia* (Cambridge: Cambridge University Press, 1988), p. 281.

[3] A definition broadly in line with the work of: Jameson W. Doig and Erwin C. Hargrove (eds.), *Leadership and Innovation* (Baltimore: John Hopkins University Press, 1987); William H. Riker, *The Art of Political Manipulation* (New Haven: Yale University Press, 1986); Michael D. Cohen and James G. March, *Leadership and Ambiguity*, 2nd ed. (Boston: Harvard Business School Press, 1986); and Norman Frohlich, Joe A. Oppenheimer, and Oran R. Young, *Political Leadership and Collective Goods* (Princeton: Princeton University Press, 1971).

[4] The term 'policy window' refers to a change in party politics that provides entrepreneurial technocrats with an opportunity to pursue their ideas for policy reform. Jeffrey T. Checkel, *Ideas and International Political Change: Soviet/Russian Behavior and the End of the Cold War* (New Haven: Yale University Press, 1997), esp. chp. 1.

with technology guru Li Kwoh-ting at the forefront.[5] This group was originally motivated by a belief that technological upgrading in Taiwan was strongly dependent on the emergence of more mature capital markets. They were able to launch their policy agenda after 1980 as the KMT came to see securities reform as an efficient means of co-opting support among Taiwan's growing middle-class (socio-political window opens). Securities reform peaked and then gradually consolidated after 1987 because the growth and complexity of the local securities sector at that time was unacceptable to the ruling party (sectoral-strategy window opens). The eight years or so between these two windows of opportunity meant that the development technocrats were obliged to make securities liberalization a gradual and methodical exercise – a process that ultimately spanned more than a decade and saw many of the development technocrats come and go over this timeframe.

DIAGRAM Con.1 Waves of financial reform in Taiwan through the late 1980s



Notes: Diagram shows the three main waves of financial liberalization over the late 1980s. Arrows indicate passage of Statute for the Administration of Foreign Exchange (July 1987), Securities Exchange Law (January 1988), and National Banking Law (July 1989) respectively. HI and LI stand for high and low reform intensity. Diagram is intended as a simple graphical representation only. No claim is made for the values indicated.

In chapter 4, we reviewed the speedy pattern of foreign exchange reform. This reform episode was tied to the ideas and effort of the 'finance technocrats' – a small and exclusive group of policymakers loyal to finance expert and long-term policy practitioner Yu Kuo-hwa.[6] The enigmatic Yu and his immediate circle were driven by a firm but intensely private conviction that the established forex system had outlived its original rationale. Early in 1986, the finance technocrats' reform agenda was assured the attention of the KMT because it became an effective tool to buttress party support among Taiwan's ailing small to medium sized

[5] The development technocrats were a latter-day version of the 1950's industrializing reformers. Stephan Haggard and Chien-kuo Pang, 'The Transition to Export-Led Growth in Taiwan' in Joel D. Aberbach, David Dollar and Kenneth L. Sokoloff (eds.), *The Role of the State in Taiwan's Development* (Armonk: M.E. Sharpe, 1994), p. 68-69.

[6] Wang Jun, *Caijing Jubo: Yu Guo-hua Shengya Xingjiao* [A Master of Finance: Yu Kuo-hwa's Career and Travels] (Taipei: Sunbright Publishing Company, 1999), p. 248.

enterprises (socio-political window opens). Within the space of a year, the technocrats' reform program received full backing from the ruling party because the established foreign exchange system was beginning to threaten the KMT's conservative priorities for monetary policy (sectoral-strategy window opens). The negligible period of time between these two windows meant that the finance technocrats were able to make foreign exchange liberalization an expeditious course of action – a process that was more or less completed with the departure from office of Yu in mid 1989.

And finally, in chapter 5 we examined the middling process of bank liberalization. This reform episode was driven by the 'young reformers,' a group of younger technocrats that included among their number Shirley Kuo and Wang Chien-shien.[7] The young reformers were motivated by two related factors: a belief that the local banking sector was grossly inefficient and uncompetitive, and a vision that Taiwan's financial system could one day compete as a regional or global financial center. From early 1985, the young reformers commenced their campaign for bank reform as the KMT regime suffered from the effects of the 10th Credit Cooperative scandal (sectoral-strategy window opens). They were given full sway to implement their plans after mid 1988 because the ruling party saw bank reform as a way of sidetracking or diffusing the influence of the newly assertive *guanxi qiye* (socio-political window opens). The median period of time between these two windows meant that the young reformers crafted a style of bank reform that had features of both the securities and forex episodes – i.e. neither incremental nor rapid but somewhere in between these two extremes. The entire reform cycle ultimately took eight years to complete and roughly coincided with the young reformers' peak career years.

The explanatory power of my theory of technocrat leadership stands in stark contrast to the poor insights offered by the established analytical approaches to financial reform. The standard tools of political and policy science – including the market-driven approach, statist analysis, pluralism and the foreign pressures model[8] – are less than satisfactory in their elaboration of the Taiwan case. In broad terms, the shortcomings of these alternative theories can be reduced to two closely related points. On the one hand, the established approaches attribute very little power of choice to policy elites. Some of the theories (e.g. statist analysis) are less guilty of this sin than others (e.g. the market driven approach), but all four give the agency involved in

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[7] Also known as the NTU Gang (i.e. National Taiwan University) or *Taida Bang*. See: Cong-rong Li, 'Guojia yu Jinrong Ziben: Weiquan Shicong Zhuyi xia Guomindang Zhengquan Yinhang Zhengce de Xingcheng yu Zhuanxing [The State and Financial Capital: KMT Bank Policy Form and Development under Authoritarian Rule] unpublished Masters manuscript, Department of Sociology, Tunghai University, Taiwan (1994), p. 108.

[8] Respectively: Richard O'Brien, *Global Financial Integration: The End of Geography* (London: Pinter Publishers, 1992); Louis W. Pauly, *Opening Financial Markets: Banking Politics on the Pacific Rim* (Ithaca: Cornell University Press, 1988); Frances McCall Rosenbluth, *Financial Politics in Contemporary Japan* (Ithaca: Cornell University Press, 1989); and Eric Helleiner, *States and the Reemergence of Global Finance: From Breton Woods to the 1990s* (Ithaca: Cornell University Press, 1994).

decision-making an analytical back seat.[9] We have seen, however, that technocrat ideas and actions in Taiwan's three waves of financial reform cannot simply be explained away by structural imperatives. Even under circumstances in which external constraints were strong – e.g. the pressure of inflation after late 1986 or the influence of the *guanxi qiye* after mid 1988 – the relevant technocrats were never impelled to pursue one particular course of action on finance policy. There was always *some* room for variation in response, and often the clearest alternatives were the anathema of liberalization. Further, on several occasions, it was not obvious in an institutional sense who would pick up the reform chalice. Later initiatives in the process of securities reform, for example, were advanced by SEC Chairmen Shen Pei-ling and C.P. Chang. Formally speaking, their role in reform after 1987 could just as easily have been assumed by the Minister of Finance (either Robert Chien or Shirley Kuo). The key difference was motive: Shen and Chang were part of a technocratic team that saw securities reform as a developmental priority. Chien and Kuo, while not opposed to securities reform in a generic sense, simply did not carry this personal and professional agenda.

On the other hand, the four established theories of financial reform also paint an inaccurate picture of the structural constraints that *did* count in Taiwan's reform experience. Knowledge of the history, ideology and organization of the ruling KMT is crucial to appreciate how financial reform became a practical option during the late 1980s.[10] There were certainly exceptions to this rule: an interesting story about insurance reform after 1986 can be told with almost exclusive reference to American pressure for market opening. This being said, virtually every other example of finance policy change over the period of relevance to this thesis is linked to KMT politics. From the first moves to open the stock market in the early 1980s to the liberalization of bank entry in the early 1990s, an appeal to ruling party priorities was vital to ensure the success of financial policy change. Of course, in making this claim I am not simply offering yet another structuralist theory of financial liberalization. Focusing exclusively on the KMT for an explanation of RoC financial reform leaves us with an account devoid of ideas: the Taiwan case of financial liberalization had a programmatic component that was rational in a strictly policy sense, and had little to do with KMT priorities whatsoever. These plans for change were invariably linked to particular technocrats who understood the highly specialized

[9] Which is not to claim that I am giving agency the steering wheel. My project is less ambitious: to reclaim a level of analytical importance for agency that is at least on par with structural factors in political explanation. In pursing this goal, I have some strange but interesting bedfellows across the gamut of political science. See e.g.: Philip G. Cerny, *The Changing Architecture of Politics: Structure, Agency and the Future of the State* (London: Sage Publications, 1990); Joan Always, *Critical Theory and Political Possibilities: Conceptions of Emancipatory Politics in the Works of Horkheimer, Ardorno, Marcuse and Habermas* (Westport: Greenwood Press, 1995); Patricia S. Mann, *Micro-politics: Agency in a Postfeminist Era* (Minneapolis: University of Minnesota Press, 1994); and Philip Pettit, *A Theory of Freedom: From Psychology to the Politics of Agency* (Oxford: Oxford University Press, 2001).

[10] An argument based on my empirical findings, but supported theoretically by the work on party politics and economic policy. The classic statement of the position is: Douglas Hibbs Jr., 'Political Parties and Macroeconomic Policy' in *American Political Science Review* Vol. 71, No. 4 (December 1977). And for recent work on political parties and economic reform, see e.g.: Javier Corrales, 'Presidents, Ruling Parties and Party Rules' in *Comparative Politics* Vol. 32, No. 2 (January 2000).

issues concerned.[11] While KMT politics shaped the field of action, people and their ideas determined the ultimate outcome. The 'meat' of Taiwan's reform story resides in the interaction of these two entities.[12]

Although it is not the purpose of this thesis to speak beyond the reform moves that spanned the late 1980s, a few words regarding the listless path of financial reform over the 1990s are probably warranted in closing. Several journalists and academics have commented that policy adjustment in Taiwan stagnated over the last decade of the 20th Century.[13] Despite the best efforts of the economic technocrats in the 1980s, key tasks in the process of opening remained incomplete. Some of the more obvious areas included: internationalization of the NT dollar, full privatization of the state-owned banks, adherence to the intention as much as the letter of national treatment for foreign financial institutions operating in Taiwan, and consolidation of linkages between local securities markets and leading exchanges elsewhere. Estimates of the level of waste or lost investment associated with continuing financial restrictions such as these varied anywhere between US$2 billion and US$20 billion a year (at the upper-end, just less than 1% of average GDP for the 1990s).[14] In addition to outstanding areas of reform, a new set of problems associated with the merging of Taiwan's financial markets (a logical outcome of the reform initiatives instituted earlier) complicated the agenda for policy change. At the forefront of the problems was the increasing politicization and volatility of Taiwan's community financial institutions; these local non-banks went to the wall at the rate of roughly two a year from 1990 to 2000. In many respects, the exposure of the 'loopy end' of Taiwan's financial system was inevitable. As one academic commentator remarked in an interview: 'The introduction of market forces has uncovered the weakest players. We should expect them to go bankrupt and accept the cost.'[15]

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[11] In line with an increasing number of scholars studying ideas and policy change, I am not convinced by claims that ideas are in some sense disembodied entities waiting for problems to arise (a.k.a. the 'garbage can model'). The truth is, not everyone can carry or communicate policy proposals, and the more technical the area, the more likely that policy solutions will be married to particular individuals or groups. This position is broadly commensurate with the work of Checkel, Odell, Sikkink and to some degree Haas. See esp.: Jeff Checkel, 'Ideas, Institutions and the Gorbachev Foreign Policy Revolution' in *World Politics* Vol. 45, No. 2 (January 1993); John Odell, *US International Monetary Policy: Markets, Power and Ideas as Sources of Change* (Princeton: Princeton University Press, 1982); Kathryn Sikkink, *Ideas and Institutions: Developmentalism in Brazil and Argentina* (Ithaca: Cornell University Press, 1991); and Peter Haas, *Saving the Mediterranean: The Politics of International Environmental Cooperation* (New York: Columbia University Press, 1990).

[12] I think Checkel puts it best: 'My aim is not to show either the primacy of agents over structure or the reverse. Rather, I have explored how advocates of change and political leaders are constrained and motivated by institutions and international structure.' Checkel, *Ideas and International Political Change: Soviet/Russian Behavior and the End of the Cold War*, fn. 4, p. 123.

[13] See e.g.: Elizabeth Thurbon, 'Two Paths to Financial Liberalization: South Korea and Taiwan' in *The Pacific Review* Vol. 14, No. 2 (2001); and Christopher Ruhr, 'Opportunity Cost: Can Taipei Build a Regional Financial Center Without Internationalizing the NT Dollar?' in *Topics* [monthly magazine of the American Institute in Taiwan] (April 1995).

[14] Various interviews with economists in Taipei, 1996 and 1999.

[15] Interview in Taipei with Norman Yin, Department of Banking, National Chengchi University, 6 July 1996.

The unfinished business of reform was certainly a matter of concern to the generation of policy elites that came of age over the 1990s. During this period, a number of very liberal-minded technocrats took senior posts within the executive branch: Lien Chan (Premier, Vice President), Lawrence Liu (Director of APROC, more below), Paul Chiu (Minister of Finance), Schive Chi (Chair of the CEPD) and a rehabilitated Hsu Li-teh (Chair of the CEPD, Vice Premier). Their efforts to keep the financial reform momentum of the late 1980s alive resulted in some creative policy innovations. Foremost among these was the so-called Asia-Pacific Regional Operations Center plan (APROC – *Yatai Yingyun Zhongxin*), established in January 1995. This high-profile program sought to coordinate liberalization efforts in five key areas of the RoC economy: manufacturing, transport, telecommunications, media and, most importantly, finance.[16] Reform targets were set in all of these areas, and were held up to the public for comment – a move that spawned the creation of several watchdog groups such as the 'APROC Clock,' an initiative of the European Chamber of Commerce in Taiwan. APROC was the ideational home of reformist thinking in the RoC for much of the mid to late 1990s, and the source of several hard-fought advocacy campaigns (e.g. WTO admission). In the end, however, the program's achievements were marginal. Many of APROC's key goals were reduced to legislative 'statements of intent,' and by the end of the decade the financial reform agenda remained largely unchanged. Opposition to reform merely hardened with the onset of the East Asian financial crisis in 1997-98, and from this point to the summary dissolution of the program in late 2000, APROC floundered.[17]

Perhaps ironically, technocrat incapacity in the 1990s was linked to the same structural forces that permitted reform successes a decade earlier. KMT politics in the last years of the millennium offered no substantive prospect for policy change; there were no party political 'windows of opportunity' for the latest band of economic technocrats to exploit. There were, however, some close calls. The socio-political calculus of the ruling party received a substantial shock in 1993 when a core of mainlander politicians broke away from the KMT to form the New Party. In 1999, tensions between popularist and machinist elements in the party, roughly correlating with a rural-urban divide, gave rise to two prospective KMT candidates for the 2000 presidential election (James Soong and Lien Chan). Both of these events could have generated a socio-political window for reform, but Lee Teng-hui's vice-like grip on the upper reaches of the KMT contained the damage to the party's social support base and prevented any policy spillover.[18] Further, the sectoral calculus of the ruling party came under stress from one

[16] *Jingji Ribao* [Economic Daily News] (18 January 1995), p. 2; *Plan for Developing Taiwan as an Asia-Pacific Regional Operations Center* (Taipei: Council for Economic Planning and Development, Executive Yuan, 1995); and various articles in *Free China Review* Vol. 45, No. 11 (November 1995).

[17] *ECCT Newsletter* [monthly bulletin of the European Chamber of Commerce in Taiwan] (various editions, 1996-1999); and various interviews in Taipei, 1996 and 1999.

[18] Interviews and observations in Taipei, 1996 and 1999. Especially grateful for discussions with Mr Wang Chien-shien, Chairman, the Renewal Foundation, 9 July 1999; Prof. Ye Kuang-shi, Lecturer in Organization and Human Resources at the Department of Business Management, National Sun Yat-sen University, 28 February 1999; and Kuo Cheng-tian, various occasions, 1999. See also: Gregory W.

or two financial scandals. In the Hualon incident of October 1994, for example, Hualon Group CEO Oung Da-ming was indicted for a share manipulation scheme that saw four major securities firms default on US$124 million in margin loans and the stock market plunge 300 points in a single day. While the potential for financial meltdown was serious at the time, the incident was effectively contained, and by early 1995 Oung Da-ming' exploits were a distant memory. As with various runs on community financial institutions, the Hualon case was small fry compared to, say, the 10th Credit Cooperative scandal of 1985.[19] In the 1990s, reformist technocrats would search in vain for an excuse to implement their agenda for financial opening.

At its most basic, financial reform in Taiwan is an intriguing tale of technocrat aspirations – brought to life by party political opportunities or stymied by party political constraints. Leadership practices matter in cases of finance policy change. The key question for the researcher is to determine *when* and *how* such practices will be successful. While this thesis has only shown the validity of my theory of technocrat leadership in the Taiwan case of financial liberalization, it is hoped that others will see merit in further tests. It strikes me as highly implausible that Taiwan alone should possess a cohort of 'smart and dedicated' technocrats crafting financial markets. Giving credit where it is due is an agenda for policy research just as much as a reform goal.

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Noble, 'Luring the Multinationals, Unleashing the Locals: Beyond Authoritarian Developmentalism in Taiwan,' draft research paper, Department of International Relations, Research School of Pacific and Asian Studies, Australian National University (February 1997).

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Hsu Li-teh, b.1931
Photo taken c. late 1980s.
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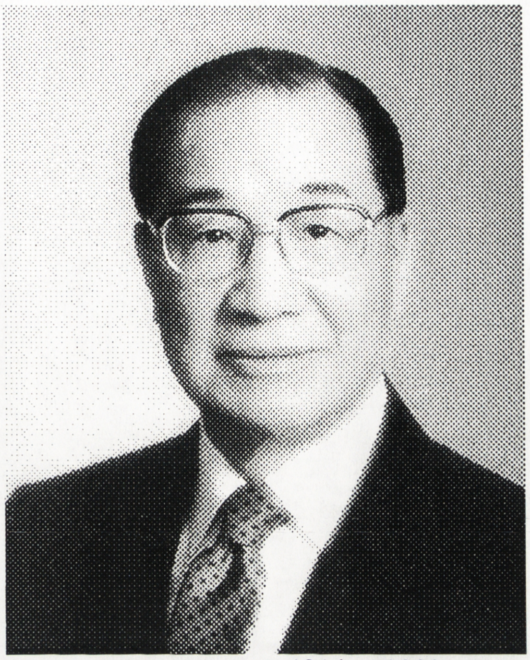

Yu Kuo-hwa, b.1914, d.2000
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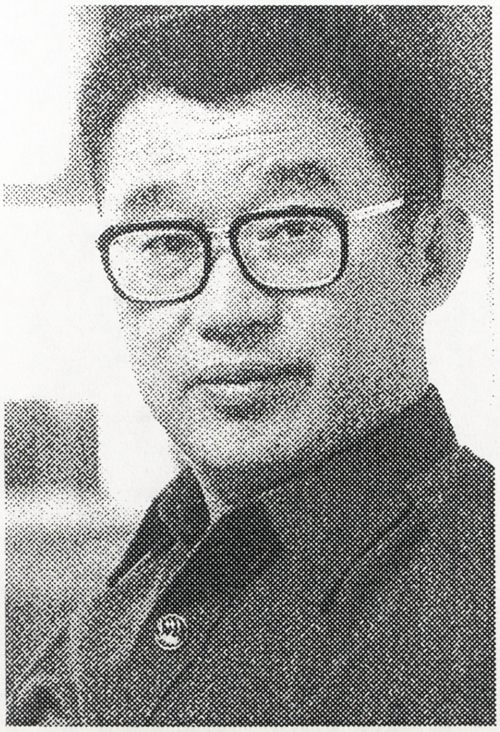

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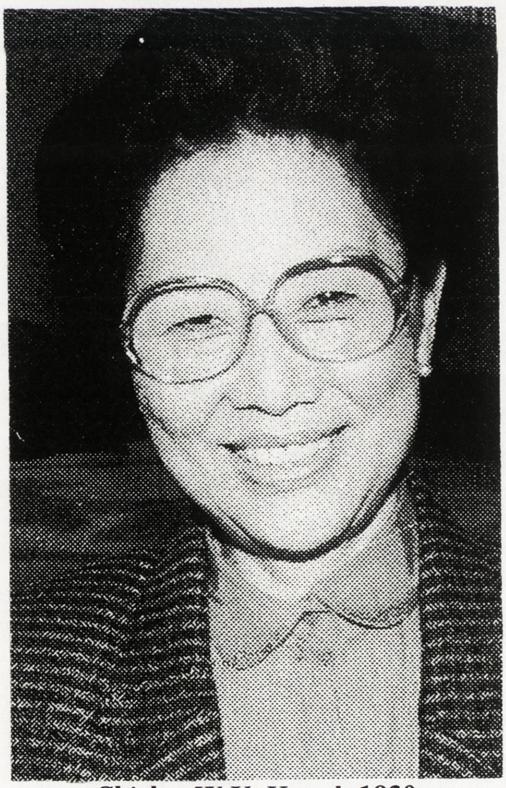

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-Schedule of Taiwan contacts-

Includes research interviews, personal correspondence, newspaper interviews, and government, business or academic contacts. Information is current at the time of association. Names are given in: (1) the Romanized or English form commonly used by the individual concerned, and (2) full-form Chinese characters. Where no common Romanized or English form is available, Pinyin is used as indicated with superscript^{PY}. Where Chinese characters are unavailable, name is given in Romanized or English form alone.

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